RAIL MERGERS AND FORMATION OF THE BURLINGTON NORTHERN HOLDING COMPANY

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

RAIL MERGERS AND FORMATION OF THE
BURLINGTON NORTHERN HOLDING COMPANY

MARCH 26, 1982

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RAIL MERGERS AND FORMATION OF THE BURLINGTON NORTHERN HOLDING COMPANY

FRIDAY, MARCH 26, 1982

U.S. Senate,
Committee on the Judiciary,
Washington, D.C.

The committee met, pursuant to notice, at 9:05 a.m., in room 2228, Dirksen Senate Office Building, Hon. Max Baucus (acting chairman of the committee) presiding.

Staff present: Peter N. Chumbris, counsel for majority; and Rick Applegate, senior legislative assistant to Senator Baucus.

OPENING STATEMENT OF SENATOR MAX BAUCUS

Senator Baucus. The hearing will come to order.

Today the committee will hear testimony on railroad mergers and the formation of the Burlington Northern Holding Co. Over the past several years, a number of major rail mergers have occurred. Today's rail industry appears to be healthier in many respects. But it is not clear that this can be attributed to the mergers of the sixties and the seventies.

At the same time, a persistent chorus has been heard concerning the competitive situation in America's transportation system. Weak railroads continue to stagnate or go bankrupt, causing difficulty for shippers and employees. Strong railroads produce complaints by shippers who feel they are captive to excessive rates.

Today we want to explore the extent to which rail mergers are beneficial and the extent to which they impose costs on competitors, shippers, and employees.

I continue to believe that we need healthy railroads in a competitive environment. At the same time, it is clear we need responsible railroads. Railroads must meet a sometimes difficult dual test. They pursue profit and at the same time the public interest. I know that this is not an easy standard but I believe it is an essential one.

These issues have been raised sharply with the formation of the Burlington Northern Holding Co. Some urge that the holding company will allow BN to prosper and that rail service will improve. Others contend that the holding company will sound a death knell to the railroad either by diverting natural resource assets and income from the railroad or by encouraging some other corporation to acquire the holding company and eventually junk the railroad.

I know that some of our witnesses today may address themselves to the 19th-century railroad land grants. This is an old issue that generates considerable controversy. For my part, I believe that the Federal Government should determine once and for all whether the land grants created a continuing obligation for rail carriers to provide rail service. We cannot resolve that issue today, but I do hope that one day an appropriate forum will do so.

We have a long witness list. We do not have a long day. I will repeatedly encourage witnesses when they give their testimony to summarize as much as possible. Otherwise, if witnesses read their entire statements throughout the day, I am afraid we will not be able to conclude. I must warn everybody that I will be quite strict in imposing some time limits.

We will begin with Congressman Pat Williams and Senator John Melcher from Montana as well as Bill Fogarty representing the Governor of the State of Montana. John, it is good to have you here today. Why don't you begin, John and then Pat follows and then Bill after that.

STATEMENT OF HON. JOHN MELCHER, A U.S. SENATOR FROM THE STATE OF MONTANA

Senator **Melcher**. Thank you, Mr. Chairman. I want to compliment you for your efforts in holding these hearings on matters which both of us know are so important to our State. I am very pleased to join you, our House colleague, Pat Williams, and our Governor's representative from Montana, Mr. Fogarty in these hearings.

These hearings regarding railroad mergers and the BN Holding Co. could not be more timely, given the effect that actions completed and contemplated have or will have on our State's economy.

NORTHERN LINES MERGER

Back in the late sixties and up until 1970, when the Great Northern, Northern Pacific, and Burlington merger was first proposed and eventually consummated, many promises and assurances were made to both shippers and employees. Protective conditions were established by the Interstate Commerce Commission to insure both open and fair competition for any of the merged railroad's rail carrier competitors. Assurances of shipper services at freight rates at competitive levels with other areas were made.

What happened? Seven years later the Milwaukee Road, the merged railroad's prime competitor from our perspective, filed for bankruptcy. Two years after the filing, the Pacific Coast Extension of the Milwaukee across Montana ceased operation. Well, so much for protective conditions in the merger.

What about the Justice Department and its Antitrust Division? Not much help coming from them either. The ICC therefore had better look close at the Union Pacific, Missouri Pacific and Western Pacific merger and the need for protective conditions unless Montana and our Nation's other Northwest States experience resulting from the northern lines merger is to be repeated.

Some might conclude that Montana's economy can only support one railroad. Well, I will tell you this. I know Montana and I know Montana can support and vitally needs more than one railroad.

With this belief in mind and with the help of my colleagues from Montana, we fought to preserve the competitive option for Montana. I say option because at first we tried to breathe life into the Milwaukee through reorganization plans.

We encouraged purchasers to buy out all or part of the line with the idea of preserving service through to the west coast and finally we fought for and obtained rail banking funds to at least obtain right of way to preserve the potential of future competitive rail services.

ANTI-COMPETITIVE BEHAVIOR

Instead of a preserved potential of competition, we now have the BN cinching our State tighter than a hangman's noose by joining with the State of South Dakota to run and eventually take title to the Milwaukee line into Terry, Mont., and by proposing to abandon more than 60 percent of its branch lines in Montana.

The BN move in South Dakota is particularly troublesome to me because it forecloses forever rail competition in eastern Montana, which is the northern end of the vast Powder River coal deposits. With the BN operating the South Dakota to Terry line, only one railroad will be operating from the northern end of the world's largest coal field. And yet the Justice Department tells me that, in essence, Montana can only support one railroad. Yet, grain, lumber and other products are also shipped in large quantities as well as coal from Montana.

The Burlington Northern is also strangling Montana with its branch line abandonment policy. The BN a year ago proposed to abandon more than 60 percent of its branch line mileage in Montana. Yet remember in the merger days Montanans were assured of improved service. They were also promised well-maintained tracks. Instead, the abandonments, some of which the ICC has already approved, mean no service on those lines and many of these abandonments, are the result of deferred branch line rail maintenance. Ask BN and they will tell you every time that it just is not worth fixing up the right-of-way, the roadbed and the rail. Let it die. Let those branch lines go by the board. So much for promises and assurances of the merger.

At least ICC Administrative Law Judge Hopkins knows the story. That is that the BN has market dominance in Montana and is charging unreasonable rates. I hope the Commission sustains Judge Hopkins' opinion in the *McCarthy Farms, et al.* case.

LAND GRANTS

As to the holding company issue, my first concern for the formation of holding companies from land grant railroads is the fact that the land grants made by Congress to these railroads were for the purpose of obtaining and sustaining railroad transportation service. By creating a holding company, these assets are spun off from the railroad to another subsidiary and, in many cases, to a number of subsidiaries. While this may appear to be a change without profound impact, the reality is to the contrary.

As the Milwaukee bankruptcy clearly demonstrated, once spun-off, these assets are those of the subsidiary and would not be available for direct support of the cash needs of the railroad without a court order. While the Milwaukee was not land granted on its Pacific Coast extension, nevertheless, this bankruptcy itself ought to change the ICC's mind regarding its role in enforcing the use of these grants for the support of railroad service operations.

RATES

Second, the holding company scenario concerns me because of the contract rate provisions that were put into the Staggers Rail Act. Competitors of subsidiaries of the BN Holding Co. could be unfairly disadvantaged in contract rate negotiations because the BN Railroad could give BN's other subsidiaries preferential rates.

For example, in Montana, BN's subsidiary, Plum Creek Lumber, which competes with Champion International and other lumber companies, could get rates more favorable than Champion or other lumber companies. The ICC has no authority over contract rates as a result of the Staggers Rail Act. And these rates are set in secret out of the public eye. There is no protection there. How about the Antitrust Division of Justice? Well, they could not find any violation in the merger conditions by BN, and I am not sure how alert they are going to be in finding that any contract rates are being anticompetitive.

Finally, I would like to address rates. As Administrative Law Judge Hopkins' decision so accurately found, BN's grain rates were excessive.

BN will tell you exactly why the rates in Montana and North Dakota are high. They are honest about it. It is that they have to recoup their margins lost in areas like Nebraska and Kansas, where they hold down grain rates to meet their competitors' rates. But why should Montana shippers subsidize shippers in areas where there is competition. Is that not discriminatory on its face?

And what about the unit train rates? BN promised to preserve the 26-car rates; sure, they are preserving them, but the differential between the 26-car rate and the 52-car rate keeps getting bigger and bigger. So, what good is it to preserve the 26-car rate if you squeeze the economic value out of its very existence? Rail freight rates can kill Montana's economy.

It is up to all of us to protect the public interest. By us I mean the shippers, the State public service commissions, the State officials, the ICC, the Department of Justice, and Congress itself. To my mind, we are not doing a good enough job of protecting the public interest, and I hope this hearing is a step toward reversing that.

Mr. Chairman, I would like to submit for the record the decision of Judge Hopkins in *McCarthy Farms, et al.*, v. *Burlington Northern, Incorporated,* which I referred to in my statement.

Senator BAUCUS. Without objection, that will all be included. Also, I have a statement submitted by Senator John Stennis which I would like to include in the record.

[Material referred to follows:]

INTERSTATE COMMERCE COMMISSION

SERVICE DATE
DEC 14 1981

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DECISION

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DOCKET NO. 3780[illegible]

McCARTHY FARMS, INC., ET AL.
v.
BURLINGTON NORTHERN INC.

Decided: December 8, 1981

By James E. Hopkins, Administrative Law Judge:

By complaint filed on March 27, 1981, complainants McCarthy Farms, Inc., Alan Larson, Dale L. Skaalure, Viggo Anderson, Rasmussen Farming Corp., Mattson Brothers, Inc., and Sheridan Green Co., Inc., allege that they individually, and other growers and elevators they represent, as a class, have been subjected to the payment of rates and charges for the transportation of wheat, and other grains, over the lines of the defendant, from stations in Montana to Pacific Coast terminals in the states of Oregon and Washington that, were and are unreasonably high in violation of 49 U.S.C. 10701(a) and former section 1(5) of the Interstate Commerce Act (49 U.S.C. Sec. 1(5).

This complaint was filed with the Commission on referral from the U.S. District Court of Montana, Great Falls Division by order dated March 16, 1981. In the Court proceeding, the complainants sought the prescription of reasonable rates and reparations. The Court referred the matters concerning the reasonableness of the rates to the Commission and stayed its proceeding pending Commission determination of that issue.

This matter was referred to the undersigned for handling under the modified procedure. The verified statements and exhibits submitted are hereby received in evidence.

Statement of Facts and Contentions of Parties

The named complainants are growers of grain and elevators, and grain operators in the state of Montana. McCarthy Farms, Inc., is a farming corporation located in Plentywood, Sheridan County, MT. Alan Larson is a representative of a farming partnership who resides at Big Sandy, Choteau County, Viggo Anderson is a representative of a farming partnership, residing at Great Falls, Cascade County, Rasmussen Farming Corporation is a farming corporation operating in Hogeland, Blaine County, Mattson Brothers, Inc., is a farming corporation operating in Chester, Liberty County. Sheridan Grain Co., Inc., is a corporation with its principal offices in Reserve, Sheridan County and is engaged in the operation of a grain elevator business.

The complaint before the Commission challenges the reasonableness of rates on wheat and barley, published in North Pacific Coast Freight Bureau Tariff No. 4011 (ICC NPCF 4011-A, formerly No. 13) Items 5200 through 6412 (wheat and barley), Item 3233 (wheat) of Supplement 7, (effective December 1, 1980) and Item 3027 (barley) in Supplement 11, (effective January 12, 1981). Complainants request that the Commission find the rates to be unreasonable, prescribe reasonable rates and advise the Court of the findings. The complaint was timely filed under Section 229 of the Staggers Act of 1980. (Staggers Act) and is complete. See No. 38246, Columbian Chemicals Co. v. Atchison Topeka & Santa Fe Railway Co. (decided August 28, 1981).

The defendant filed a motion to vacate modified procedure on May 18, 1981, pointing out that the same rates from the same origins to the same destination were also under challenge in No. 37815, Montana Dept. of Agriculture, et al. v. Burlington Northern, Inc., a complaint filed under Section 229 of the Staggers Act. Defendant objected to the unfair burden of having to simultaneously defend two complaints against these rates, both of which purport to protect the same interests. This motion was not ruled on by the Commission. Since the instant case has progressed to the decision stage, while No. 37815 is awaiting assignment, this Judge believes the proper action herein is for him to proceed to a decision in the instant proceeding.

The Complainants:

McCarthy as noted is a farming corporation located in Plentywood, MT. It sells its wheat to grain companies. It is paid the Portland, OR price per bushel.

Dale L. Skaalure is a partner in the farming partnership of Skaalure Brothers, which is located 15 miles southeast of Big Sandy, MT. Skaalure Brothers sells its wheat to a grain company which ships it to Pacific North Coast points via BN. It is paid the Portland market price, less freight and handling charges.

Viggo Anderson is a partner in the farming partnership of Andersen & Hovland located in Great Falls, Cascade County, MT. Grain elevators pay the Portland price for its wheat less shipping and handling charges. More than 20 percent of its revenues go to transportation costs.

Rasmussen Farming Corp. is a farming corporation operating in Hogeland, Blaine County, MT. From September 1978 through September 1980, it sold its wheat to grain companies and coops. It contracted directly with BN for the transportation of its wheat. It owns an elevator to which its wheat was delivered and shipped directly. The price it receives is F.O.B. Portland, minus the transportation charges. Rasmussen Farming Corp. pays 20 to 30 percent of its receipts from the sale of wheat for transportation costs.

Matson Brothers, Inc. is a farming corporation located in Chester, Liberty County, MT. It sells its wheat to a food company or a farmers union. It is paid the Portland rate less handling and freight charges.

Sheridan Grain Co., Inc. has its principal offices in Reserve, Sheridan County, MT. It is in the grain elevator business.

Cost Evidence

Complainants presented voluminous cost evidence which they developed using a traffic sample of 109 carload movements taken from the one percent sample in 1979 carload Waybill Statistics, Statement TD, published by the U.S. Department of Transportation. Complainants developed specific cost data from observations of involved operations and through conversations with railroad operating personnel. In conducting their study, complainants spent more than 30 days in the field and observed operations on every major involved branch line. To the extent that they were unable to develop cost data, they used BN's 1977 Rail Form A system average unit costs, excluding fixed plant expenses and investments solely related to coal.

Rather than submit cost evidence from its own sources, BN has sought to demonstrate the existence of errors in complainants' evidence by restating the cost of the same 109 shipments. However, at the same time, BN argues that the one percent waybill sample is not a valid basis for cost studies of the issue traffic. BN maintains that traffic patterns have changed substantially since 1979 due to rate reductions and the establishment of 26 and 52 car rates that apply between points at issue in this proceeding. It states that since such rates were established, 266, 26 and 52 car trains traveling from Montana to the Pacific Northwest ports have been loaded. It also maintains that complainants have challenged the wrong rates.

BN has not shown that the one percent waybill sample is invalid. The single car rates at issue remain in effect. Although most of the grain traffic now moves under multiple car rates, that does not invalidate the sample for the purpose it is used. The presently applicable rates in Supplement 7 and 11 provide varying levels of rates depending on whether the shipment consists of a single carload, multiple car shipments of fewer than 26 cars and shipments of not more than 52 cars and are subject to expiration dates. If these rates were allowed to expire, it appears the higher rates in Item 5200 through 6412 would apply. The export rates applicable on multi-carload movements are not in dispute here. Indeed, BN's reliance on the same 109 cars is illustrative of its validity.

BN also asserts that it is somehow improper for complainants to include barley rates in their complaint because the court case only concerns wheat rates. However, there is no reason why complainants should be limited to the scope of the court case. The complaint stands on its own merits before the I.C.C.

BN argues that complainants' 30 day operating cost study does not provide sufficiently reliable data to be used in lieu of Rail Form A costs. Since BN did not seek to refute complainants' data and since the methodology used in the study is adequate, it will be accepted as the best evidence of record. The Commission has consistently held that the use of actual cost data is more desirable than Rail Form A system averages. See, Rules Governing the Assembling and Presenting of Cost Evidence, 337 I.C.C. 298, 305 (1970); General American Transportation Corp. v. Indiana Harbor Belt Railroad Co., 357, I.C.C. 102, 130, 134 (1977), aff'd sub nom., Indiana Harbor Belt Railroad Co. v. U.S., 577 F.2d 394 (1978); Absorption of Switching Charges, Southern Territory, 361 I.C.C. 883, 887 (1979), Ex Parte No. 355, Cost Standards for Railroad Rates, 364 I.C.C. 898, 903 (1981).

Finally, BN advocates the use of its 1977 Rail Form A including fixed plant expenses and investments solely related to coal. It maintains that the Commission in Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines-Nationwide, 364 I.C.C. 360 (1980) is severely limiting the use of fixed plant investment additives. This is not persuasive. No final decision has been reached in Ex Parte No. 347 (Sub-No. 1). Moreover, if BN were allowed to use its Rail Form A costs that include these additives in both grain and coal proceedings, it would in effect be allowed duplicate recovery of the investments.

The following is a discussion of other aspects of BN's cost evidence and complainants' revised cost evidence.

A. Train Characteristics

(1) Net Tons. Both parties used the same net tons per car from the sample.

(2) Tare Weight Per Car. BN used tare weight tons from the sample while complainants used BN's Form A system average. Although BN's methodology is more precise, it does not appear to make an appreciable difference in the cost results.

(3) Number of Locomotives Used. Through their study, complainants determined the number of locomotives used in origin service as well as the number of destination way trains or the operations performed at destinations. They used Rail Form A data concerning locomotives used in through services. BN relied wholly on Rail Form A data.

(4) Gross Tons Per Train. Complainants calculated the gross tons for origin trains by assigning a lading weight of 100 tons for covered hopper cars and 58 tons for boxcars observed at each station. A relationship was drawn between the percentage of tonnage traveled between each station to the total distance to form a weighted average for the line segment. For those lines on which no study was performed, complainants used Rail Form A data. Complainants used system average data for gross tons per train for through trains and destination way trains where applicable. BN relied entirely on system average data.

(5) Car-Mile Methodology. Both parties used the same methodology.

(6) Empty Return Ratio. BN used, without explanation, a 100 percent empty return ratio. Complainants' use of BN's Rail Form A system average is more reasonable.

B. Switching Minutes

(1) Switching Minutes Per Carload at Origin. Complainants developed switching minutes per carload at origin for the origin stations studied and used Rail Form A data for the remainder. BN used Rail Form A data.

(2) Destination Switching Minutes. Both parties used Rail Form A data.

(3) Switching By Yard Locomotives. Complainants used data developed through field observations and discussions with operating personnel in some cases supplemented by BN Rail Form A data. BN used Rail Form A data.

(4) Inter/Intratrain Switching. Complainants adopted BN's methodology of using its Traffic Analysis System to obtain data on intertrain switches as the sample cars moved from one train to the next. However, complainants did not accept the results for four movements. They contend that the result for those movements was too high and therefore relied on Rail Form A data for the four movements. Complainants approach appears to be reasonable.

C. Grain Doors

Complainants state that the Rail Form A does not develop a separate unit cost for installing grain doors in boxcars, but rather includes it under Terminal Train Supplies and Expenses (TTSE). They believe that the cost per carload for TTSE would tend to understate the actual cost of providing grain doors. They have therefore adopted the grain door cost of BN witness L. J. Day in Seasonal Rates on Grain to Minnesota and Wisconsin, 362 I.C.C. 79 (1979). This was updated by the general overhead ratio and indexed. BN states that based upon I.C.C. Statement 153-72, Rail Revenue Contribution By Commodity and Territory for the Year 1972 (Burden Study), it used 8.5 percent of TTSE for each car. Complainants' cost calculation is more completely documented and appears to be the more reasonable.

D. Car Costs

(1) Railroad Owned. Complainants accepted BN's Traffic Analysis System as an appropriate source for data on car-hours. However, they found that the data relied upon by BN included time during which cars were under demurrage, bad ordered, and unaccountably backhauled twice during one linehaul movement. They also found

that for some cars for which the prior or subsequent movement was a loaded move, BN had considered half the time to be as an empty move and for some moves for which the records did not show prior or subsequent empty moves, BN assumed that the moves were empty movements. Complainants adjusted the BN data to correct for these factors.

BN used rental factors from Ex Parte No. 334, Car Compensation - Basic Per Diem Charge - Formula Revision In Accordance with the Railroad Revitalization and Regulatory Reform Act of 1976, 361 I.C.C. 189 (1979) to calculate costs. It then updated the costs to the April 1, 1981 level. Complainants assert that it is inappropriate to update the car repair portion. Complainants calculated BN's average repair costs per car for boxcars and covered hopper cars in 1978, 1979 and 1980. They state that during the period, the average repair cost for 40 foot boxcars increased by 7.0 percent, the repair cost for 50 foot or longer boxcars decreased by 17.1 percent and for covered hopper cars it decreased by 8.2 percent. Average car repair costs per mile increased by 46.4 percent for 40 foot boxcars, decreased by 18.1 percent for 50 foot or longer boxcars and decreased by 7.8 percent for covered hopper cars. Complainants attribute the increase for 40 foot boxcars to a precipitous drop in car-miles that is either the result of erroneous data or abnormal conditions. Complainants attribute the overall decrease in repair costs to the net increase in the size of the covered hopper fleet through the acquisition of new cars coupled with the reduction in the boxcar fleet through the retirement of old cars. This is plausible because repair expenses may be expected to vary directly with the age of the car fleet. Complainants have argued convincingly that the use of the updating factor that is based solely on average changes in material prices and wage rates results in an apparent distortion in car repair costs.

BN also added general overheard costs to the car hire rates. Complainants objected, arguing that Ex Parte No. 334, supra, includes distribution of general overhead expenses between car ownership costs and other expenses. They conclude that the result is an overstatement of car costs. Complainants' discussion does not differentiate when such expenses are incurred by car owners and car users, respectively. In instances where cost studies incorporate actual car hire rates paid by car owners by foreign railroads, the overhead expenses incurred by both owning and using railroads should be included. Specifically, overheads borne by the car owners are included within the car hire rate, while a provision for overheads borne by the car user is reflected through application of the user's Rail Form A overhead ratio to the car hire monies paid. However, in situations where single line traffic is loaded in the handling railroad's own cars (as is generally true with the involved traffic) and where car ownership costs based upon Rail Form A average are rejected in favor of rates in the car hire table reflecting specific car ages and values, the overhead costs of only one railroad constituting both owner and user need be covered. Thus, for purposes of this proceeding a general overhead ratio should not be separately applied to the car hire rate applicable to BN equipment.

(2) Privately Owned. The parties used actual per diem and mileage rates in computing costs for privately owned cars.

K. Crew Wages

Complainants developed crew wages through their study. BN used Rail Form A costs.

F. Indexes

Complainants developed indexes to use in increasing BN's 1977 Rail Form A costs to the April 1, 1981, level. They used the procedure described in the publication, ICC Statement No. 1E3-78, Explanation of Rail Cost Update Procedure, to develop a weighted average index for the BN and UP. The index factors used in the calculations were obtained from the publication, Indexes of Railroad Material Prices and Wages, Series QMPW 111, published by the Association of American Railroads. The 1977 base year expenses, rents, and taxes were obtained from BN's and UP's R-1 Annual Reports. Net car hire rents were excluded from the calculation because car hire data was based upon current car hire rates.

BN also states that it followed 1E3-78 procedures. However, BN calculated a weighted index to reflect both expenses and embedded debt cost of capital. Since complainants have provided the details of their calculations while BN has not, and since the use of a weighted index is inappropriate, complainants' index is the accurate one.

G. Helper Service

Complainants included the cost of two SD-40 locomotives for 36 miles each for helper service. BN states that complainants should have used 72 miles to take into account two empty returns. The helper service cost included herein is for westbound trains. Defendent submitted no evidence to show that the returning locomotives are not used in eastbound trains. Therefore, I have accepted complainants' helper service unit cost based upon 36 miles.

H. Miscellaneous Costs

(1) UP Reciprocal Switching Cost. In situations where the destination line haul railroad delivers the loaded cars to another carrier as Union Pacific does at Portland for placement at consignee facilities, the charge assessed by that carrier ordinarily constitutes a better measure of the linehaul railroad's costs than its Rail Form A system average data. However, in the instant proceeding complainants' destination terminal cost derived from Rail Form A and updated including an allowance for constant costs, closely approximates the $64.74 charge. These costs reflect the destination functions performed by UP, i.e., road train-industry switching, special services, and terminal train supplies and expenses. Because both methods produce essentially the same result, complainants' calculations for the Portland movements do not appear unreasonable.

(2) Loss Damage. Complainants used BN's 1980 loss and damage data.

(3) Terminal Train Supplies and Expenses. Complainants adjust Terminal Train Supplies and Expenses to reflect the Burden Study factor of .08515 for railroad-owned covered hoppers.

(4) Embedded Cost of Capital. Complainants state that they revised the embedded cost of capital to reflect the 1980 levels of 6.4222 percent for road property and 9.6460 percent for equipment.

Summation of Cost Evidence

All of the differences between the parties in their cost presentation, with the exception of the matter of tare weight, are resolved in favor of complainant. In new of the negligible effect upon total costs arising from minor differences between average tare weight and specific tare weights recorded for cars in respondent's study, the net result of the probable combination of overstatements in complainant's calculation is believed to be hardly perceptible. Thus, the revenue/cost ratios as calculated by complainant and which appear in the following table constitutes the best evidence of record with respect to handling the subject traffic.

In sum, complainants have demonstrated through their cost evidence that the involved traffic has the following aggregate ratios of rate to cost:

	Rate Variable Cost (Ratio Basis)	Rate/Fully Allocated Cost (Ratio Basis)
Original Base Tariff		
Embedded Debt Cost of Capital	2.92	2.37
Current Cost of Capital of 19 Percent	2.79	2.21
Supplements 7 and 11		
Embedded Debt Cost of Capital	2.46	2.00
Current Cost of Capital of 19 Percent.	2.35	1.86

Market Dominance

When this complaint was filed on March 27, 1981, the regulations regarding market dominance were those promulgated in Ex Parte No. 320, Special Procedures for Findings of Market Dominance, 353 I.C.C. 874 (1976). On June 24, 1981, the Commission in Ex Parte No. 320 (Sub-No. 2), Market Dominance Determinations, 365 I.C.C. 118, issued new market dominance regulations, which became effective on August 7, 1981. Complainant argues in this proceeding that due process should prevent the application of the guidelines promulgated in Ex Parte 320 (Sub-No. 2). Complainants in this instance have not shown that a manifest injustice would result from the application of the new guidelines. Cf. Bradley v. Richmond School Board 416 U.S. 696, 711 (1974). The new guidelines will be applied in this case.

Under section 10709(d) of the Act, in the period from October 1, 1981 through September 30, 1982, the Commission must find that the rail carrier publishing a challenged rate does not have market dominance over the transportation to which the rate applies, if the carrier proves that the rate charged results in a renewal-variable cost percentage for such transportation, that is less than 165 percent, during the period beginning October 1, 1982 and ending September 30, 1982. As shown earlier herein complainants have demonstrated by their cost presentation, and as evaluated by me, that the involved traffic returns revenue substantially exceeding that threshold.

As to intramodel competition, complainant points out that BN is the only railroad running from Montana to the Pacific Coast, which proves that it has an effective monopoly. While this appears true as to rail competition, BN points out that there are other means of transportation of grains. It points out that since 1953 eight dams have been completed on the Columbia and Snake Rivers.

As a result there has been a consequent creation of slack water pools, and a large number of grain elevators established at river locations. These elevators receive grain by truck and ship by barge to Portland and Astoria, OR and Kalama and Vancouver, VA. BN presents evidence that shows that the shipments of grain through the locks of the Bonneville Dam grew from 1,276,939 tons in 1960 to 5,356,873 in 1980.

The traffic at McNary Dam grew from 2,000,266 tons in 1974 to 4,765,939 tons in 1980. The traffic at Lower Granite Dam grew from 147,519 tons in 1975 to 1,164,604 tons in 1980. BN states that in order to meet truck/barge competition, on 15 occasions it lowered its rates for grain shipped westward. It also submitted statistics gathered by the Montana Crop and Livestock Reporting Service that show that from December 1979 - May 1980 and June - November 1980, 35.0 and 50.6 percent, respectively, of all Montana wheat that was shipped out of state was transported by truck. BN also showed that during the same periods, 32.6 and 49.3 percent of the wheat shipped west was transported by truck. The aggregrates for the one year period are 42.6 percent and 40.7 percent, respectively. The data does not show any barge transportation.

Complainants contend that BN's evidence concerning grain shipments by barge is meaningless because it concerns all grains, not just wheat and barley. They also point out that there is no indication of how much of the grain is from Montana. Complainants state that there are no barge unloading facilities east of the Bonneville Dam, which is the last lock of the river system prior to reaching Portland and other export locations. Therefore, the data for the Bonneville Dam is cumulative for the whole system. However, complainants introduced their own evidence concerning grain transported through the Bonneville Dam. This shows that from April, 1980 through May, 1981, 7,064,687 tons of grain moved by barge through the dam. Of that, 5,192,595 tons was white wheat that is produced in Oregon, Washington and Idaho. Complainants contend that very little of the 414,897 tons of barley and 1,457,195 tons of spring and winter wheat transported through the dam came from Montana. Complainants state that according to unloading records, less that 7 percent of the unloading receipts are for trucks.

Grain elevators in Montana are required to furnish the Montana Department of Agriculture with information concerning all grain purchased and where and how it is shipped to points outside Montana. The data shows that in 1979 and 1980, 83.3 and 83.1 percent, respectively, of the wheat and 72.7 and 69.2 percent, respectively, of the barley that moved directly from Montana origins to Pacific Coast points moved by rail. In December 1980, coincidental with BN's publication of multiple car rates, the respective percentages for wheat and barley jumped to 90.9 and 93.6 percent.

The Commission in Ex Parte No. 320 (Sub-No. 2), supra, changed its approach in considering the issue of market dominance. This is not the result of a change in the statutory definition, which as set out in Section 10709(a) remains "an absence of effective competition from other carriers or modes of transportation for the transportation to which a rate applies." Ex Parte No. 320 (Sub-No. 2) made geographic competition and product competition considerations in determining market dominance. "Geographic competition is a restraint on rail pricing stemming from a shipper's or receiver's ability to get the product to which the rate applies from another source, or ship it to another destination." Ex Parte No. 320 (Sub-No. 2) supra, at 128. It is apparent from the defini tion-as well as the suggested types of evidence concerning geographic competition listed at p. 134, that in considering geographic competition, the Commission intends to look outside the scope of the routes to which the challenged rate applied and to look at other markets to determine their competitive effect on the extent of the railroad's true economic power to independently set the price for its services.

Complainants have shown that BN, as the sole railroad providing rail transportation between Montana and the Pacific Northwest ports, is the predominant source of transportation for Montana wheat and barley to those ports. Complainants' evidence from the Montana Department is persuasive concerning BN's position in the overall market in the transportation of the involved grains between Montana and the Pacific Northwest ports. The fact that BN's share of the transportation market jumped significantly in December 1980, when it introduced multiple car rates, is persuasive that it has strengthened its market position. Although the statistics in question do not take into account truck/barge intermodal transportation, complainants have convincingly shown that barges are not a major means of transportation to these points. This is buttressed by the absence of evidence concerning barge transportation in the statistics of the Montana Crop and Livestock Reporting Service relied upon by BN.

BN's evidence concerning the overall patterns for the interstate shipment of Montana wheat and barley is not in and of itself persuasive that substantial geographic competition exists. Absent information such as is suggested at p. 134 in Ex Parte No. 320 (Sub-No. 2), supra, it is not possible to determine to what extent geographic competition is a restraining factor upon BN in its market practices. Ex Parte No. 320 (Sub-No. 2), supra, at 132 places the burden on defendant to come forward with convincing evidence of geographic and product competition and only then for complainant to seek to refute it. BN has not adequately descibed how these factors exist. BN's evidence regarding geographic and product competition is inconclusive and thus will be given minimal weight. Id. at 130.

Therefore, on the basis of the evidence at record, I conclude that BN has market dominance.

One further aspect of the argument concerning market dominance merits comment. BN has made much of the fact that when Montana farmers are paid for their grain, the grain companies deduct the cost of shipping it to Portland, irrespective of whether or not it is shipped to Portland. While this may explain the strong interest of the farmers in having the rate lowered, it is not germane in considering market dominance. BN also presented evidence concerning the shipping patterns of individual complainants to show that their wheat goes to other points. The evidence was not useful to show the overall extent and nature of geographic competition for Montana wheat and barley.

Reasonableness

Complainants introduced a variety of cost evidence in seeking to demonstrate that the rates are unreasonable. They calculated BN's earnings per car, per car-mile and per ton-mile for shipments between the involved points. Per car earnings range from $1390 to $2105, per car-mile earnings from $1.47 to $1.89, and per ton-mile earnings from 3.0 cents to 3.7 cents. (See Appendix A.) These computations are based upon loadings of only 100,000 pounds per car although complainants found in the waybill sample that loadings averaged 164,000 pounds.

Complainants compared the involved shipments with shipments traveling similar distances via BN between points in Nebraska, Kansas, Colorado and Wyoming to points in the Pacific Northwest. Their comparison shows the Montana rates to be consistantly earning a greater return on all three bases. (See Appendix B.) Complainants also showed BN rates on export corn from Minnesota and Nebraska to demonstrate that the rates are lower than the BN wheat and barley rates despite the greater distance the corn is shipped. (See Appendix C.)

BN justifies its rates by stating that it must vary its prices according to source and product competition forces. With over half of its tonnage moving at rates below fully allocated costs, it must try to make up the difference by charging more than the fully allocated costs where it can. It states that if it were to raise its prices for those rates that are below fully allocated costs, it would lose much of its business. This business contributes to meeting its fixed costs and return requirements. BN notes that in Ex Parte No. 393, Standards for Railroad Revenue Adequacy, 364 I.C.C. 393 (1981), the Commission held that in order to be considered revenue adequate, a railroad must earn a rate of return equal to the current cost of capital. Id. at 809-811. In

Ex Parte 393, *supra*, at 821 and 826, the Commission found BN to be revenue inadequate. BN cites the Railroad Revitalization and Regulatory Reform Act of 1976 and the Staggers Act as reflecting Congressional concern that the railroads be allowed to attain adequate revenues. BN reasons that the Staggers Act allows the railroads greater flexibility in setting rates and restrains them only where there is an abuse of power unrestrained by any economic force. It denies that it has abused its economic power.

Complainants dispute the Commission's findings in Ex Parte No. 393. They contend that the revenue figures are understated as result of the use of betterment accounting. Complainants argue that BN's assertion that its overall revenues are inadequate conflicts with its own evidence that its return on investment increased from 2.2 percent in 1977 to 5.1 percent in 1980 and that stockholders' equity increased from 4.2 percent in 1977 to 9.7 percent in 1980. They also quote BN's *Annual Report to Stockholders for 1979* showing that consolidated earnings for 1979 rose 53 percent and that consolidated net income and consolidated revenues grew at the annual rates of 22 and 13 percent, respectively. Grain traffic rose 37 percent over 1978 and related revenues rose by 33 percent. The 1980 report was quoted to show that net income rose by 27 percent and consolidated revenues by 23 percent. During 1980, grain volume rose 29 percent while grain revenues rose by 45 percent. While grain represented 14 percent of BN's total traffic volume, it accounted for 16 percent of its total revenue.

Complainants maintain that the fact that the price of BN stock rose 206.9 percent in two years and has risen since is proof that BN is not handicapped in attracting capital.

DISCUSSION AND CONCLUSIONS

The complaint filed with the Commission in this case was filed during the 180 day period established by Section 229 of the Staggers Act, during which existing rates could be challenged. The fact that complainants filed their court action before the effective date of the Staggers Act has no bearing on the consideration of its complaint by the Commission. The two actions are not coextensive since the complaint includes barley while the court action does not. Moreover, absent a resulting manifest injustice or evidence that the application of the Staggers Act would be contrary to Congressional intent , it is appropriate to apply the law in existence at the time of the decision. *Bradley* v. *Richmond School Board, supra*.

Section 229(d) places the burden of proof on the complainant. This in fact represents no change from the standard applicable before the enactment of the Staggers Act. Section 229 creates no new presumptions. See discussions regarding sections 201 and 229 in *Report of the Committee on S. 1946*, Rep. No. 96-1430. 96th Cong., 2nd Sess. (1980).

In Ex Parte No. 393, *supra*, the Commission carefully implemented the mandate in Section 10704(a)(c) that it maintain and revise standards and procedures for for establishing revenue levels adequate to cover total railroad operating expenses, including depreciation and obsolescence, plus a return capital.

Recently, the Commission decided that public comment on its revenue adequacy determinations was not necessary. Using current data, following the standards set out in Ex Parte No. 393, *supra*, it found that BN was revenue inadequate. Ex Parte No. 416, *Railroad Revenue Adequacy - 1980 Determination*, 365 I.C.C. 285, 287, 288 (1981). The Ex Parte Nos. 393 and 416 decisions clearly establish that BN does not receive adequate revenues. BN must raise its overall revenues to at least equal the level of the cost of capital in order for it to remain a viable financial entity over the long run. In order to keep the total system functioning, it is necessary to take into account competitive factors in setting prices.

While the challenged rates are undoubtedly high, that does not make them per se unreasonable. *Agrico Chemical Co.* v. *Seaboard Coast Line Railroad Co.*, 361 I.C.C. 333, 336, (1979). Complainants' comparison of BN's return from shipments covered by the challenged rates with similar rates from other points are of limited value. It would have been more meaningful if the revenue/cost ratios for similar shipments, were compared rather than merely comparing unit revenues. Still they are another indication of the high level of the complained of rates as compared to rates for similar moves from other origins.

The question that must be decided here is under what circumstances a can the Commission find a rate or group of rates to be unreasonably high where the carrier complained of is found to be revenue inadequate.

The Conference Committee on Page 80 of the Report on the Staggers Act stated:

'"The specific goals of this Act are to assist the industry in the rehabilitation and financing of the rail system; to reform Federal Regulation to preserve a safe adequate, economical, efficient and financially stable rail system, to assist the rail system to remain viable in the private sector of the economy; and to provide a regulatory process that balances the needs of carriers, shippers, and the public. The overall purpose of the Act is to provide, through financial assistance and freed from unnecessary regulation, the opportunity for railroads to obtain adequate earnings to restore, maintain and improve their physical facilities while achieving the financial stability of the national rail system."

Should the Commission as a result of such a declaration and similar statements in the Act, close its eyes and stamp its approval on rates on grain, as here, that return an excessively high level of return, above variable and fully allocated costs, so that the rail carriers, such as BN here, can receive overall adequate revenues. Should the grain farmers, the elevator operations, the millers, and finally the consumers of grain products, subsidize the producers and consumers of other products transported by rail at a level below the fully - allocated cost level. Where is the level reached in costing that we can finally say "the rate in effect is unreasonably high." Would it be reasonable for the defendant here to raise its rates on grain and other high return commodities, in order to reach the level of return that the Commission would consider adequate, while keeping other low rate commodities at a low level of rates.

While it is clear that the Congress desires the Commission to remove the dead hand of regulation from the railroads and allow management to set its price level through resort to the marketplace, it is clear also, that the Congress did not intend to remove all outside influence from the transportation price setting field.

The Burlington Northern states here, that "in a competitive multi-service industry such as the railroad industry, with a high percentage of fixed and joint cost, the significance of fully allocated costs is that of an average, the average of what we must reserve on all of our traffic and nothing more. It cannot serve as a guide to pricing, or a floor or a ceiling, Railroads cannot set all rates equal to the level of fully allocated costs in order to obtain overall revenue adequacy."

The Commission has recognized the need for differential pricing and has upheld such a standard of rate-setting but it also must, while it still has the mandate, provide a regulatory process that balances the needs for carriers, shippers, and the public.

The evidence presented herein as graphically shown in the table picturing the aggregate ratios of rate to cost of the movements complained of herein, show that for the original base tariff using the Embedded Debt Cost of Capital bases, the aggregate ratios of rate was 2.92 of variable cost on a ratio basis and 2.79 using current cost of capital of 19 percent. On the same basis the fully allocated costs were 2.37 and 2.21. The multiple car rates were also as shown in the table to be far above fully allocated cost.

The totality of the evidence indicates that the level of rates on grain complained of herein, are unreasonable insofar as the rates charged result in a revenue variable cost ratio above 200%. By setting the reasonable rates on the grain movement involved herein, at 200% of variable costs, the defendant will still receive a more than adequate return on the movements in issue. Such a ratio should allow the carrier to obtain more than adequate earnings on the grain traffic involved, while balancing the needs of the shippers and receivers. The return prescribed, is also somewhat higher than the level set in determining whether a rail carrier has market dominance. Consideration has been taken of BN's need for the differential pricing of the commodities it transports in order to return an overall adequate return.

The complainents herein have not requested the Commission to award reparations contrary to the defendant's arguments. While the award of reparations by the Court, could result in an award of millions of dollars to the class of complainants therein, and against a carrier that the Commission has considered revenue inadequate, that matter is not one that this Judge is to consider here. I am only to consider the prior and present reasonableness of the grain rates in issue.

Requested findings and arguments not specifically discussed in this decision nor reflected in the findings and conclusion herein have been considered and found not justified, or their resolution unnecessary for the disposition of this proceeding. It is also concluded that this proceeding is not a major Federal action significantly affecting the quality of the human environment or conservation of energy resources.

Ultimate Findings and Order

Upon consideration of the record it is found (1) that the defendant has market dominance over the involved wheat and barley traffic. (2) that present and past rates complained of are and were when assessed and collected unreasonable insofar as they exceed or exceeded 200 percent of the variable cost of service and (3) that a revenue to variable cost ratio of 200 percent is found to be the maximum reasonable rate for the transportation of the wheat and barley complained of herein.

It is the Order of the Administrative Law Judge, that on or before 20 days from service of this decision and upon not less than 1 day notice to the Commission and the general public, defendant shall cancel the schedules containing the assailed rates to the extent found in excess of the maximum reasonable rate. New schedules should be filed consistant with the findings herein.

By the Commission, James E. Hopkins, Administative Law Judge.

(SEAL)

AGATHA L. MERGENOVICH
Secretary

Appendix A

Complainant's Exhibit CLB-3
Witness; Brennan
Page 1 of 6

WHEAT RATE, EARNINGS AND
SHORT LINE MILEAGE FROM
POINTS IN MONTANA TO
PORTLAND, OR (853411)

NO.	STATION	MILES	RATE	+ SC	PCR	PCME	PTME
706122	Big Sandy	933	146	149.21	1492.	1.60	.032
702880	Box Elder	923	148	151.26	1513.	1.64	.033
703690	Brady	838	141	144.10	1441.	1.72	.034
708542	Broadview	1012	165	168.63	1686.	1.67	.033
704980	Brockway	1276	198	202.36	2024.	1.59	.032
706794	Cascade	821	136	138.99	1390.	1.69	.034
718135	Chadborn	886	149	152.28	1523.	1.72	.034
703160	Chester	837	148	151.26	1513.	1.81	.036
702446	Chinook	920	154	157.39	1574.	1.71	.034
703640	Conrad	825	142	145.12	1451.	1.76	.035
703375	Devon	811	146	149.21	1492.	1.84	.037
703378	Dunkirk	803	146	149.21	1492.	1.86	.037
703738	Dutton	856	139	142.06	1421.	1.66	.033
706420	Fort Benton	894	141	144.10	1441.	1.61	.032
701793	Frazer	1082	182	186.00	1860.	1.72	.034
702858	Gildford	869	150	153.20	1532.	1.76	.035
704659	Glendive	1213	195	199.29	1993.	1.64	.033
706720	Great Falls	850	136	138.99	1390.	1.64	.033
708720	Hardin	1045	170	173.74	1737	1.66	.033
702435	Harlem	941	158	161.48	1615	1.72	.034
702862	Hingham	863	149	152.28	1523	1.76	.035

Complainant's Exhibit CLB-3
Witness: Brennan
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WHEAT RATE, EARNINGS AND SHORT LINE MILEAGE FROM POINTS IN MONTANA TO PORTLAND, OR (853411)

NO.	STATION	MILES	RATE	+ SC	PCR	PCME	PTME
702868	Inverness	850	149	152.28	1523.	1.79	.036
706135	Kershaw	889	141	144.10	1441.	1.62	.032
706153	Kershaw	889					
703177	Lothair	824	147	150.23	1502.	1.82	.036
701580	Macon	1106	184	188.05	1881.	1.70	.034
701187	Medicine Lake	1201	193	197.25	1973.	1.64	.033
706749	Mocassin	938	147	150.23	1502.	1.60	.032
709437	Molt	999	170	173.74	1737.	1.74	.035
701788	Nashua	1065	181	184.98	1850.	1.74	.035
701715	Opheim	1316	193	197.25	1973.	1.50	.030
701575	Poplar	1122	186	190.09	1901.	1.69	.034
703773	Power	866	138	141.04	1410.	1.63	.033
704620	Richey	1255	198	202.36	2024.	1.61	.032
702865	Rudyard	857	149	152.28	1523.	1.78	.036
701330	Scobey	1267	193	197.25	1973.	1.56	.031
703383	Shelby	793	145	148.19	1482.	1.87	.037
704150	Sidney	1206	195	199.29	1993.	1.65	.033
706461	Stanford	919	145	148.19	1482.	1.61	.037
703650	Valier	845	143	146.15	1462.	1.73	.035
701590	Wolf Point	1101	184	188.05	1881.	1.71	.034

Complainant's Exhibit CLB-3
Witness: Brennan
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WHEAT RATE, EARNINGS AND SHORT LINE MILEAGE FROM POINTS IN MONTANA TO KALAMA, WA (849610)

STATION	MILES	RATE	+ SC	PCR	PCME	PTME
Broadview	1030	165	168.63	1686.	1.64	.033
Fallon	1202	195	199.29	1993.	1.66	.033
Great Falls	868	136	138.99	1390.	1.60	.032
Hinsdale	1044	174	177.83	1778.	1.70	.034
Macon	1125	184	188.05	1881.	1.67	.034
Peerless	1306	193	197.25	1973.	1.51	.030
Poplar	1140	186	190.09	1901.	1.67	.033
R[illegible]land	1318	193	197.25	1973.	1.50	.030
Sidney	1224	195	199.29	1993.	1.63	.033

Complainant's Exhibit CLB-3
Witness: Brennan
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WHEAT RATE, EARNINGS AND SHORT LINE MILEAGE FROM POINTS IN MONTANA TO TACOMA, WA (846203)

NO.	STATION	MILES	RATE	+ SC	PCR	PLME	PTME
704980	Brockway	1254	198	202.36	2024.	1.61	.032
704440	Carlyle	1252	206	210.53	2105.	1.68	.034
706720	Great Falls	827	136	138.99	1390.	1.68	.034
704480	Wibaux	1221	198	202.36	2024.	1.66	.033

Complainant's Exhibit CLB-3
Witness: Brennan
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WHEAT RATE,EARNINGS AND SHORT LINE MILEAGE FROM POINTS IN MONTANA TO VANCOUVER, WA (849936)

NO.	STATION	MILES	RATE	+ SC	PCR	PCME	PTME
708550	Billings	977	165	168.63	1686.	1.73	.035
701567	Brockton	1126	188	192.14	1921.	1.71	.034
703640	Conrad	815	142	145.12	1451.	1.78	.036
701782	Glasgow	1041	180	183.96	1840.	1.77	.035
706140	Fort Benton	884	141	144.10	1441.	1.63	.033
701510	Froid	1178	193	197.25	1973.	1.67	.033
702843	Havre	888	151	154.32	1543.	1.74	.035
702862	Hingham	853	149	152.28	1523.	1.79	.036
702868	Inverness	840	149	152.28	1523.	1.81	.036
702855	Kremlin	869	150	153.30	1533.	1.76	.035
701580	Macon	1096	184	188.05	1881.	1.72	.034
701187	Medicine Lake	1191	193	197.25	1973.	1.66	.033
709437	Molt	989	170	173.74	1737.	1.76	.035
701153	Plentywood	1213	193	197.25	1973.	1.63	.033
703383	Shelby	783	145	148.19	1482.	1.89	.034
703327	Sunburst	810	148	151.26	1513.	1.87	.037
701590	Wolf Point	1091	184	188.05	1881.	1.72	.034

Complainant's Exhibit CLB-3
Witness: Brennan
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WHEAT RATE, EARNINGS AND
SHORT LINE MILEAGE FROM
POINTS IN MONTANA TO
LONGVIEW, WA

NO.	STATION	MILES	RATE +	SC	PCR	PCME	PTME
	Big Sandy	962	146	149.21	1492.	1.55	.031
	Box Elder	951	148	151.26	1513.	1.59	.032
	Box Elder						
	Broadview	1041	165	168.63	1686.	1.62	.032
	Cascade	850	136	138.99	1390.	1.64	.033
	Chadborn	915	149	152.28	1523.	1.66	.033
	Chester	865	148	151.26	1513.	1.75	.035
	Devon	840	146	149.21	1492.	1.78	.036
	Frazer	1111	182	186.00	1860.	1.67	.033
	Great Falls	878	136	138.99	1390.	1.58	.032
	Great Falls	878					
	Hingham	891	149	152.28	1523.	1.71	.034
	Inverness	879	149	152.28	1523.	1.73	.035
	Kershaw	918	141	144.10	1441.	1.57	.031
	Opheim	1345	193	197.25	1973.	1.47	.029
	Rudyard	885	149	152.28	1523.	1.72	.034
	Scobey	1296	193	197.25	1973.	1.52	.030
	Ulm	865	136	138.99	1390.	1.61	.032

TARIFF AUTHORITY: ICC BN 6003, ICC NPCF 4011

RATES IN CENTS PER 100 POUNDS. REVENUE AND EARNINGS IN DOLLARS.

PCR - PER CAR REVENUE

PCME - PER CAR MILE EARNING

PTME - PER TON MILE EARNING

BASED ON 100,000 POUNDS PER CAR.

SC - RATE PLUS EX-PARTE 311 SURCHARGE OF 2.2%

Complainant's Exhibit CL3-4
Witness: Brennan
Page 1 of 2

WHEAT EXPORT RATES ON BN FROM POINTS IN CO, KS, NE, AND WY TO PORTLAND SHOWING COMPARISON OF EARNINGS WITH RATES FROM POINTS IN MT TO POINTS IN PACIFIC NORTHWEST

STATION	MILES	RATE	+ SC	PCR	PCME	PTME
		NEBRASKA				
Crawford	1406	175	178.85	1789.	1.27	.025
Opheim, MT (L)	1345	193	197.25	1973.	1.47	.029
Alliance	1464	175	178.85	1789.	1.22	.024
Northport	1489	187	191.11	1911.	1.28	.026
Hyannis	1523	179	182.94	1829.	1.20	.024
Aurora	1752	191	195.20	1952.	1.11	.022
Venango	1638	183	187.03	1870.	1.14	.023
Curtis	1727	187	191.11	1911.	1.11	.022
		KANSAS				
Horton	1870	187	191.11	1911.	1.02	.020
		COLORADO				
Brush	1605	179	182.94	1829.	1.14	.023
Denver	1692	167	170.67	1707.	1.01	.020
Sterling	1570	170	173.74	1737.	1.11	.022
		WYOMING				
Cody	1072	175	178.85	1789.	1.69	.033
Frazer, MT (P)	1082	182	186.00	1860.	1.72	.034
Frannie Jct.	1030	167	170.67	1707.	1.66	.033
Glasgow, MT (L)	1041	180	183.96	1840.	1.77	.035
Casper	1287	167	170.67	1707.	1.33	.027
Brockway, MT(P)	1276	198	202.36	2024.	1.59	.032
Wendover	1386	167	170.67	1707.	1.23	.025
Opheim, MT (L)	1345	193	197.25	1973	1.47	.029

(L) Longview, WA

(P) Portland. OR

Complainant's Exhibit CLB-4
Witness: Brennan
Page 2 of 2

TARIFF AUTHORITY: ICC BN 6003, ICC NPCF 4011,ICC TCFB 3029-P
RATES IN CENTS PER 100 POUNDS. REVENUE AND EARNINGS IN DOLLARS.
PCR - PER CAR REVENUE
PCME - PER CAR MILE EARNING
PTME - PER TON MILE EARNING
BASED ON 100,000 POUNDS PER CAR.
SC - RATE PLUS EX-PARTE 311 SURCHARGE OF 2.2%

Appendix C

STATION	MILES	RATE	+ SC	PCE	PCME	PTE
Appleton, MN	1653	156	159.43	1594.	.964	.019
Glenwood, MN	1635	156	159.43	1594.	.975	.019
Minneapolis, MN	1742	156	159.43	1594.	.915	.018
Culbertson, NE	1709	145	148.19	1482.	.867	.017
Hastings, NE	1730	145	148.19	1482.	.857	.017

EC

SERVICE DATE
JUL 3 0 1982

INTERSTATE COMMERCE COMMISSION

DECISION

No. 37809[1]

MC CARTY FARMS, INC., ET AL.

v.

BURLINGTON NORTHERN INC.

Decided: July 21, 1982

The purposes of this decision are: (1) to reopen the record in No. 37809, McCarty Farms, Inc., et al. v. Burlington Northern, Inc.; (2) to institute a separate proceeding, No. 37809 (Sub-No. 1), McCarty Farms, Inc., v. Burlington Northern Railroad Co., to consider separately the reasonableness of the barley rates discussed in the initial decision in No. 37809; (3) to consolidate these two proceedings with No. 37815S, Montana Dept. of Agriculture, et al. v. Burlington Northern, Inc.; and (4) to rule on Montana's motion to compel discovery filed April 22, 1982.

In No. 37809, complainants filed a class action suit in U.S. District Court, alleging that rates assessed by defendant on wheat and other grains from points in Montana to Pacific Coast terminals in Oregon and Washington are unreasonably high. The suit was referred to the Commission for resolution of certain issues, including maximum reasonableness of rates for wheat. In an initial decision served December 14, 1981, an Administrative Law Judge found that the challenged rates are unreasonable to the extent they exceed 200 percent of variable costs.

In No. 37809, the record has been closed and an initial decision issued; defendant's appeal of the initial decision is now pending. However, due to the circumstances of these cases and because recent decisions (referred to infra) have further defined our current approaches to various costing and jurisdictional issues where maximum reasonableness of rates is in issue, it is appropriate to reopen this proceeding.

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[1] This proceeding also embraces No. 37809 (Sub-No. 1), McCarty Farms, Inc. v. Burlington Northern Railroad Company and No. 37815S, Montana Dept. of Agriculture, et al. v. Burlington Northern Inc. No. 37809 (Sub-No. 1) removes the issue of reasonableness for rates on barley from the lead docket; the reasons for this administrative action are discussed in the decision.

When the complaint in No. 37809 was filed with the Commission, it added allegations of unreasonableness of rates for barley. Defendant argues, and complainants agree, that the barley rates are not at issue in the court suit. Complainants argue that both barley and wheat rates should be considered together, since filing a separate complaint at this Commission would be a duplication of efforts. It is true that the same tariff is involved, the origins are the same (within the state of Montana), and the destinations involve the same ports in Washington and Oregon. Nevertheless, there are two important differences which require a separate proceeding. First, the court referral case is a class action suit on behalf of all Montana wheat producers and shippers. Because the Commission's rules do not permit class action suits, the complainants for the barley rates are not a class of shippers, but only those parties specificially named in the complaint. Second, the findings on wheat in No. 37809 are recommendations to the court; the findings as to barley will result in a binding Commission order. Accordingly, two separate proceedings are warranted. The complaint filed in No. 37809 is sufficient to institute No. 37809 (Sub-No. 1).[2] We caution complainants in No. 37809 (Sub-No. 1) that, even though the proceedings are consolidated for the reasons discussed below, they should set out specific factual contentions (origins, destinations, routings) for barley rates.

In No. 37815S, the issues relate to the maximum reasonableness of rates for the future for both barley and wheat. This proceeding is in its initial stages. No record has been developed.

Consolidation of these three cases is necessary because the issues concern similar commodities, tariffs, origins, and destinations. The destinations in No. 37809 and No. 37809 (Sub-No. 1) are to Pacific Coast terminals in Oregon and Washington. The complaint in No. 37815S alleges the unreasonableness of rates to Portland, OR, Seattle, WA, and Minneapolis, MN. Since there are overlapping interests and similarity of issues, these proceedings should be consolidated. Because of the necessity to reopen No. 37809 and to institute and define the affected interests in No. 37809 (Sub-No. 1), there will be no undue delays by consolidating these with No. 37815S.

Under these circumstances the Commission's decisional process would best be served by allowing the parties to tender additional evidence. The parties should be aware of recent decisions on various costing and jurisdictional issues.[3]

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[2] Since the complaints in No. 37809 and in No. 37815 were filed March 27, 1981, and March 26, 1981, respectively, they are timely filed within the purview of section 229 of the Staggers Act.

Our decision here to reopen the record in No. 37809 follows No. 36114 (Sub-No. 1), Potomac Electric Power Company v. Consolidated Rail Corporation and related cases (unprinted), served April 7, 1982. There it is pointed out that while maximum reasonableness in Ex Parte No. 347 (Sub-No. 1) involves coal rates, the costing analysis there and the jurisdictional-related findings in Ex Parte No. 411 establish certain principles applicable to maximum reasonableness determinations in rail cases of all types. See No. 36114, page 3, fn. 6. Because the initial decision in No. 37809 preceeded these decisions (except for Ex Parte No. 320 (Sub-No.2), it could not reflect these considerations. Accordingly, the parties should submit evidence to address these matters. Additionally, the parties may discuss any other relevant issues, and specifically those affected by the Staggers Act or recent policy changes. This new evidence is being sought to develop a complete up-to-date and standard cost presentation. No inference that our maximum reasonableness analysis will be confined to these data is warranted.

The attached appendix generally outlines the cost-related evidentiary requirements which are necessary for complete records in maximum rate proceedings. Where the type of evidence outlined in the appendix is deemed not relevant to the commodities or transportation service, or unavailable, it need not be filed.[4] If the parties find that the evidence and arguments already submitted meet current requirements of Ex Parte No. 347 (Sub-No. 1), supra, and the jurisdictional conclusions of Ex Parte No. 411, supra,[5] and Ex Parte No. 320 (Sub-No. 2), supra, they need not repeat their presentations. The parties in No. 37809 and No. 37809 (Sub-No. 1) should present only the additional evidence they conclude is necessary. If one party submits new, updated evidence, the party choosing not to do so may be prejudiced in failing to respond.

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[3] See, Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines-Nationwide (unprinted), served December 21, 1982, Ex Parte No. 411, Complaints Filed Under Section 229 of the Staggers Rail Act of 1980, 365 I.C.C. 507 (1982) and Ex Parte No. 320 (Sub-No. 2), Market Dominance Determinations, 365 I.C.C. 118 (1981), which reflect our current approaches to various cost and jurisdictional issues.

For example, the Ex Parte No. 347 (Sub-No. 1) decision, supra, places greater emphasis on equipment and fixed plant investment additives, provided any double count of these investments is satisfactorily eliminated. In addition, among other things, constant costs must be distributed on the ratio basis (rather than the ton/ton-mile basis), unless another method is justified. The decision in Ex Parte No. 411, supra, allows the application of the Producer Price Index to certain expenses and precludes use of the employee level adjustment in updating costs. It also addresses certain key jurisdictional issues, finding, among other things, that our new market dominance guidelines should be used.

Montana's motion to compel discovery filed April 26, 1982 is granted. No reply was filed. Montana's motion is predicated on defendant's lack of response to the interrogatories, rather than any dispute over the merits of the questions. Because of the current status of the other two proceedings, it is necessary for No. 37815S to go forward.

All parties should notify the Commission within 20 days concerning the most efficient filing schedule and whether the parties in No. 37815S are ready to go forward. We can allow the parties in Nos. 37809 and 37809 (Sub-No. 1) to use the same schedule that will be set in No. 37815S. Alternatively, parties in Nos. 37809 and 37809 (Sub-No. 1) may file concurrent opening and reply statements. Comments on this are invited.

It is ordered:

1. The record in No. 37809 is reopened for the possible receipt of new evidence.

2. The proceeding in No. 37809 (Sub-No. 1) is instituted for the purpose of deciding issues in No. 37809 with respect to barley rates.

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[4] For instance, complainants originally introduced cost evidence based mainly on an actual cost study of a one percent waybill sample of carload movements, as opposed to a Rail Form A study. While RFA is generally necessary as a minimum standard in maximum reasonableness cases, complainants may submit an actual cost study. The Commission has historically encouraged the use of such evidence.

[5] The parties' attention is directed to 365 I.C.C. at 510. While the decision correctly states that unemployment insurance should not be updated by the Producer Price Index, it should be increased by the same updating as wages since it is a function of wages.

3. The proceedings in No. 37809, No. 37809 (Sub-No. 1) and No. 37815S are consolidated.

4. In No. 37815S defendant is ordered to answer, within 15 days, interrogatories and request for production of documents and other materials sent to it by complainants.

5. The parties are directed to submit, within 20 days, their proposed plans for the submission of evidence and argument. Joint suggestions are encouraged.

By the Commission, Chairman Taylor, Vice Chairman Gilliam, Commissioners Sterrett, Andre, Simmons, and Gradison.

(SEAL)

AGATHA L. MERGENOVICH
Secretary

STATEMENT OF SENATOR JOHN C. STENNIS
TO THE SENATE JUDICIARY COMMITTEE

Mr. Chairman:

I have a deep interest in the continued development of the nation's transportation systems. As a member of the Public Works Committee for many years and as a member of the Transportation Appropriations Subcommittee, I have had the opportunity to participate in many of the issues which have directly affected the development of the nation's transportation system.

These hearings today are dealing with railroads, which along with our highways, waterways, ports and air terminals play a critical role in the continued health of our economy.

I am here today, Mr. Chairman, because I am concerned that the nation's common carrier system appears to be entering a new era under recently enacted deregulation legislation which could have great promise for our economy or could be highly destructive.

Railway mergers are of particular interest to me because they create enormous potential for monopolistic and destructive inefficiency. This is a danger which commands our vigilence.

The new freedoms for railroads under the provisions of the Staggers Rail Act could be harmful to the total common carrier infrastructure in my region. Today, under this act, it is possible for a rail carrier to charge a favorable rate to thru-rail delivery to the ocean ports on the Gulf or to the East Coast while charging a higher rate to barge ports on the Mississippi and its tributaries. It is clear that this kind of unbridled rate setting could be used in a destructive way to eliminate water carriers. In my own state and region I have had an interest in developing our transportation systems so as to foster the development of this region's abundant natural resources. In this regard, I have been concerned over the years with this struggle between waterways and railroads. In my state the Tennessee-Tombigbee Waterway project has been the target of an intensive effort by railroads. The first suit against the Waterway was brought by the Louisville and Nashville Railroad in 1976, and the battle has gone on for year after year in the courts and here in the Congress. One must be concerned about the millions of dollars which have been spent by railroads in opposition to this Waterway, which, in fact, will create even more growth and more business for my region's railroads. One can only conclude that it is a destructive waste to continue this kind of opposition.

Mr. Chairman, it is my hope that your work in this important field will be continued. There is a great need to continue development of the nation's transportation system. The capital costs to develop and maintain this system are mind-boggling. The President has proposed increased user taxes for our carriers as one possibility to meet these capital needs. I am not convinced that it is wise to continue to increase taxes on the transportation industry--the beneficiaries are too broad for specialized taxes. However, it may be that we need to establish a common carrier trust fund which would assess all modes of transport. This could include revenues from the fuel taxes, airport fees and customs fees already being assessed. In addition, special taxes on the income from minerals and oil from federal land grants to the railroads could be added to the trust fund.

There are other possibilities, of course, but my main point is this: Our nation's carriers must be encouraged to work for the nation's whole economic development. By their nature common carriers have the potential for monopolistic inefficiency. It is in the public interest that the Congress exercise the oversight and vigilence required to insure the transportation needs of the nation.

Senator BAUCUS. Thank you, Senator Melcher. Congressman Williams.

STATEMENT OF HON. PAT WILLIAMS, A U.S. REPRESENTATIVE FROM THE STATE OF MONTANA

Mr. WILLIAMS. Thank you very much, Senator. I am pleased to be here with you and with my colleague, Senator John Melcher, and Bill Fogarty of Governor Ted Schwinden's staff.

Before I begin my statement, I want to make note of the fact that my colleague, Congressman Byron Dorgan of North Dakota, had intended to be a witness before you today. However, he was called out of town on a personal matter. Congressman Dorgan asked if I would submit his remarks and ask your permission to have them included in the hearing record.

Senator BAUCUS. He has been a very observant participant in this process. I very much look forward to his statement. Without objection, it will be included.

Mr. WILLIAMS. I want to thank you, Senator, for inviting me to appear before the committee to discuss railroad holding companies, the obligations for railroads arising from their public land grants, and, of particular concern to folks in Montana, the Burlington Northern Railroad.

This hearing is especially timely given the current state of affairs in the railroad industry in Montana and across the country. I want to commend you, Max, for putting together an impressive list of witnesses, which shows the traditional Montana dedication to hearing all sides of an issue in a complete and responsible manner.

A moment ago I said the Burlington Northern Railroad. I say that with special emphasis on railroad because, despite the company's recent metamorphosis into a holding company, Montanans look at Burlington Northern as the railroad. For most Montanans, BN does not mean coal mining, oil and gas exploration, timber production or trucking. It means the railroad. And Montanans want it to stay that way.

We Montanans are somewhat possessive when it comes to railroads, even though we do not own them or have any real authority over their operations. When the Milwaukee Road began picking up its tracks in Montana and handing the Burlington Northern a virtual monopoly, we fought that demise of railroad competition. When Burlington Northern announced the formation of a holding company and the proposed abandonment of hundreds of miles of track in our State, we lamented what was happening to the railroad, our last railroad.

The railroad means one thing to all of us: Jobs. When the railroad thrives, we thrive. When the railroad takes a nosedive, we all follow, from the railroad workers to the shippers to the shopkeepers on Main Street. To many Montanans, the railroad's future is their future, and they want it to be bright. Folks want more rails, not fewer. They want better expanded service, not cutbacks and abandonments. They want—no, they need—more responsible freight rates, not more increases. All of this means very simply that Montanans are always concerned about anything that affects the railroad. And this holding company concerns them enormously.

THE BN HOLDING CO.

We Montanans are concerned that BN will go the route of the Union Pacific, the Milwaukee Road and others that formed holding companies. Will subsidiary companies be financially isolated one from another, and will valuable resources be transferred from the railroad to other subsidiaries for little or no compensation? Will the subsidiaries control or manage resources the railroad continues to hold?

BN retains a significant amount of land and mineral rights as a result of the enormous grants of public lands to railroads by the Federal Government in the late 1800's. These lands, given for the construction, operation and maintenance of railroads systens to connect the East and the West, continue to have vast potential public value as instruments of support for marginal operations the railroad would not ordinarily undertake or continue.

It is generally believed that these assets have not been used for a number of years for the direct support of rail operations. If they are transferred out of the railroad to other subsidiaries, or are managed and controlled by other subsidiaries they will never be available to the railroad.

In the instance of railroads which have already successfully completed such transfers, and perhaps in the case of BN, if it follows the previously worn path, the public subsidy given to the railroads to carry out the peculiarly public functions of our arteries of commerce has been effectively redirected to various energy, natural resources and other companies. Those independent companies, tied to the railroad by a paper holding company, have no authority to receive any general public subsidy, need no such subsidy, and are not compelled to perform any public service in return for such subsidy.

LAND GRANT OBLIGATION

The railroad industry insists that the obligations of the railroads to provide public services as a result of the land grants expired years ago. They make sweeping but overstated claims about giving the Government reduced freight rates during World War II. Quite simply, there are many who believe, as I do, that the public responsibilities of the railroads must be of the same duration as the land grants. So long as a railroad continues to hold and profit from the land grant resources, there must be consideration of the public need. And, certainly, we ought not allow railroads to escape that public obligation through the simple legal process of transferring their land grant wealth to other independent nonrailroad subsidiaries, or by allowing outside management or control of the land grant assets.

In my State of Montana and in many other States, Burlington Northern has proposed abandoning hundreds of miles of branch lines that it no longer considers viable. Some have not seen any traffic for years, and it is clear that there is no reason, public or private, to continue service. Others, however, have had traffic but at volumes the railroad considers insufficient to support future operations. In many cases, future operations would be dependent upon upgrading of the rail line through replacement of ties, ballast, rails, and in some instances, major structures such as bridges.

To Burlington Northern's credit, the company is trying to work out these cases on an individual basis with the shippers and the State government. One recent good example is a 19-mile line in Montana from Fairfield to Choteau. Here, BN has agreed to rebuild the line and keep it open for unit-train service with the assistance of a federally funded loan administered by the State. Between the combination of expected traffic revenue and the interest-free loan, BN believes this line should be viable for many years to come. The company is to be commended for its willingness to negotiate to keep that service in place.

There are other cases, however, that are not working out as well. For example, a 17-mile line at Valier, Mont., is proposed for abandonment because BN does not want to invest the $2 million or more that it might take to make the track safe for unit trains. The line is a busy one and important for local grain growers, who shipped about 3 million bushels of grain on that line last year. BN does not believe that level of traffic, coupled with the refurbishment and reconstruction costs, is going to make the line successful. The company may be right; it may not be a profitable line. However, given the almost nonexistent transportation alternatives for these grain growers, the line is necessary. It is in cases such as these that the land grant assets should come into play. Burlington Northern ought to call upon some of its remaining land grant properties as a source of revenue with which to upgrade the Valier line. Continuation of service on the Valier line may or may not be profitable, but it will be a public service; and public service was the intent of the land grants.

I am hopeful Burlington Northern will acknowledge that obligation as it considers how to proceed on the Valier branch line abandonment and on the abandonment of other Valiers all across America.

Mr. Chairman, I am hopeful you will be able to take the information presented by myself and the other witnesses today and develop a good record of the current problems with holding companies, their land grants and their continuing public service obligations. Speaking as a Member of the House, I stand ready to join you in responsible legislative remedies that may arise from these hearings and in hearings that I hope to hold in the House Interior Committee on legislation I introduced last year on railroad land grants.

Mr. Chairman, I would like to close with a quote made by a weary traveler to the West Coast who, more than 100 years ago, was disgusted with the attitudes of the railroads whose routes he had just traveled. At the end of his journey, he closed his diary with these words:

> Someday in this country, it will be decided that the railroads are to be run for the public, and for their benefit and accommodation. Corporations and monopolies, cliques and combinations may, for a time, oppress and hinder the people; but there always comes a day when the public assert, and asserting, maintain their rights.

Mr. Chairman, our work to fulfill that prophecy is not yet complete.

I appreciate your efforts. Thank you very much.

Senator BAUCUS. Thank you very much, Pat.

In your statement you referred to a bill you introduced which would require holding companies to utilize some of their land grant properties to contribute to the railroad. Could you amplify on that bill and explain to me what that bill is about and what the status is?

Mr. **Williams**. Yes. The bill is H.R. 4463. I introduced it last September 10. Very simply, it requires that at least one-third of the profits from a holding company's land grant assets be provided by the company to its railroad subsidiaries for the operation and maintenance of rail lines.

Senator, in the late 1800's the Federal and State governments granted about 10 percent of the entire land mass of the United States to various railroad companies. It encouraged and compelled them to construct rail lines throughout the undeveloped West and to link the Nation East and West. Today, a century later, the transcontinental railroads are in decline. Consolidations, mergers and takeovers have threatened service. Service is down and prices are up.

In 1920 we passed the Mineral Leasing Act. That prohibits railroads from leasing Federal coal. I maintain that, if that law is repealed, we have, in effect, given the railroads another land grant. Not only that, but we have opened the gates to full-scale, unfettered, and uncompetitive coal mining by railroad holding companies.

My bill simply says, if we are going to do that, if we are going to modify the Mineral Leasing Act and, in effect, give the railroads another land grant, then the public should benefit some from it. I think the way they benefit is to require the railroads to return at least a third of the profits; that is, require the holding companies to return at least a third of the profits to the railroads. Then we would earmark some of that money for maintenance and upgrading of branchlines.

Senator **Baucus**. What would your view be if railroads did not transfer land grant assets but, rather, a railroad subsidiary still retained title to land grant assets?

Mr. **Williams**. It would depend on the railroad. Ostensibly, holding titles to the property, you also get the revenues and the profits, which you then make available for rail line maintenance and operation. If the title and the ownership of land grant assets stays with the railroad subsidiary and yet the profits go elsewhere, then I think my case is made. Frankly, I think that is the situation now. Unfortunately, that was the situation before holding companies were born.

Senator **Baucus**. Thank you very much. I appreciate your taking the time.

Mr. **Williams**. Thank you, Senator.

[The statement of Representative Dorgan, submitted by Representative Williams, follows:]

[From the Congressional Record, Apr. 1, 1982]

STATEMENT OF U.S. CONGRESSMAN BYRON L. DORGAN

"A holding company is something where you hand an accomplice the goods while the policeman searches you."—Will Rogers

Mr. Chairman and Members of the Committee, we are here today to talk about railroad mergers and holding companies.

This issue is of very great concern to my state, to yours, and to the entire nation.

As you well know, the nation's longest railroad system, and number one grain hauler, the Burlington Northern, which is an economic cornerstone of our region, is rearranging itself into such a holding company. Instead of managing its affairs under one corporate roof, the BN is splintering off its various assets and enterprises—timber, coal, oil, gas, real estate, farm land, railroading, and others—so that these reside under separate roofs, linked only to a "holding company" to which they all, on paper, will belong.

Although this step is essentially just a rearrangement of the legal paper which defines the BN's existence, it is cause for alarm to all those who depend upon the Burlington Northern railroad to carry their grain and other products to distant markets.

According to the BN, the reason for setting up this complicated holding company structure is to give it more flexibility in developing its real estate, timber and coal holdings, and other assets, present and future. Under its current arrangements, it cannot develop its non-railroad ventures as much as it would like, because the Interstate Commerce Commission must approve any stock issues or other financial steps which might affect the railroad.

The ICC's timid interpretation of the law, however, has led to the view that it does not have this authority over holding companies. This interpretation has turned the holding company into an escape hatch for railroad executives in search of greener pastures.

This is why the BN has turned to the holding company form. It will isolate the railroad in a separate subsidiary, and this subsidiary alone will fall under the ICC's review. The BN will then be able to issue stock, and engage in other financing ventures, to its heart's content. It will be able to develop coal, buy an oil company, or do virtually anything else without the ICC or anyone else asking bothersome—to it—questions of the impact of these financing moves upon the railroad and upon those the railroad serves.

HISTORY TEACHES CAUTION

History counsels us to have great caution regarding holding companies that preside over sprawling empires that encompass many lines of business.

In the nineteen thirties, the collapse of the mammoth utility holding companies showed how fragile such structures can be in the face of hard financial times.

More recently, and more to the point, there was the collapse of the Penn Central, another railroad which got a gleam in its eye for the seemingly greener pastures of land and real estate development.

We should not push the comparison between the BN and the Penn Central too far. Certainly, there are differences in the mergers which formed these two companies and in the strength of the enterprises which resulted.

But there is no way that the formation of a holding company can bode well for the BN railroad. At the very best, the railroad will not grow substantially weaker. But even that is doubtful.

We must recall that the great mergers which comprised what is now the Burlington Northern, were justified—both by the BN and the ICC—largely on the grounds that the BN's coal, oil, and other holdings would greatly strengthen the merged railroad. The ICC, in its 1977 "Railroad Conglomerates and Other Corporate Structures" report, asserted that "the financial strength of BN is due in large measure to the existence and development of its nonrailway assets."

A WEAKER RAILROAD

To now strip these asssets from the railroad, and leave it standing bare, can only weaken the railroad. It can do nothing else.

This is not just a question of assets and finances, moreover. It is also a question of management time and attention. A management that wants to spend more time developing its coal and timber wants to spend less time maintaining and running a railroad. It's that simple.

This is apparent in the BN's reason for forming the holding company in the first place. If the BN does not want the ICC judging its financial moves on the basis of their impact on the railroad, then doesn't this suggest that the company might have in mind some actions which the ICC might question? Might it not be thinking of moves that, in the ICC's eyes, could weaken the railroad? Otherwise, why would the BN be jumping through all the legal hoops necessary to get out from under the ICC's jurisdiction?

These concerns are not hypothetical. The BN is heading in this direction already.

OILMEN IN SADDLE

Consider the recent changes in the BN's top management. The company has moved two individuals into top corporate slots who are not railroad men, but oil men. The BN's new Chairman Richard Bressler, is a former Atlantic Richfield Executive Vice President who, according to Business Week (March 8, 1982), "has made no secret of his intention to build up the company's nontransportation business."

The new President of the BN railroad, Walter A. Drexel, is a former ARCO tax accountant. Mr. Drexel's role, again according to Business Week, is to "give Bressler the cash flow he needs to grow the holding company's resource ventures."

This is happening now. Last year, the BN announced its intention to abandon hundreds of miles of branch lines in North Dakota and in other states. It made clear that it was going back on its long-standing commitment to the farmers of this region, so that it could redeploy these assets in more lucrative ventures.

We have stopped most of those abandonments, for the time being. But the BN can attempt them again, at any time. Its current course virtually guarantees that it will do so.

BN'S "CASH COW"

More important is the recent shift in the corporation's internal financing. With the railroad starting to produce a healthy profit, the BN's management is turning it into what Business Week called a "cash cow"—a source of cash to finance the BN's non-rail ventures.

The BN's goal, according to the magazine, is to reduce the railroad to at most only one half of the BN's total business. Business Week deduces—with good reason—that to reach this goal, the BN might do what U.S. Steel recently did—buy up an oil company.

What will happen to the Burlington Northern railroad when its role in the BN's corporate structure is so diminished? What will happen when the BN's new go-go management is spending more time on minerals and real estate then on railroading, and when it starts looking at the capital demands of the railroad and at the relatively conservative returns on this capital? Might it not conclude that railroading is a drag?

Might it not conclude that it should start getting out of railroading, or at least greatly reduce its commitment in that area?

The BN's attention to other ventures will lead it down this path of thought, if it hasn't already. And once there, who will stop the BN from phasing down its commitment to the railroad or shucking it off entirely?

WHOSE BUSINESS?

Is this of any concern to us?

The question is not rhetorical.

The BN argues that it is a private business, and that as such, it is entitled to run its affairs any way it wants. If it wants to shift away from railroading and into greener and more exciting pastures, then that's its own business, so the argument goes.

But the Burlington Northern is not just another private business. It is a public utility, serving a vital transportation need for the producers of the states which it serves. The health and soundness of this utility is the public's business.

That is just the beginning. The BN is vested with a much larger public trust—one of the most generous ever bestowed upon a private corporation in the history of this country and probably of the world.

Over one hundred years ago, the people of this Nation granted to what is now the Burlington Northern Railroad over 40 million acres of choice public lands in the great western domains of the United States. We bestowed this largesse upon the Burlington Northern for one purpose and one purpose only—to enable this corporation to build and operate a railroad for the benefit of all the people of this Nation.

The land grants were a form of endowment, vested in trust to the Burlington Northern to ensure that farmers and business people would have a healthy and reliable form of transportation, and that commerce in our part of the country could grow and thrive.

The public land grants have made the Burlington Northern wealthy to a degree that is almost beyond comprehension. It holds 14.7 billion tons of economically mineable coal, more than any other company in the United States. It has 7.5 million acres of oil and gas rights, over a million acres of grazing land, and enough timber holdings to make it the 12th largest private owner of forest land in the United States.

We did not lavish this beneficence upon the Burlington Northern so that it could become rich. We lavished it so that our Nation could have the kind of railroad system it needs to prosper. It is our responsibility in Congress to make certain that this purpose is served. Nobody else can.

OFF THE HOOK?

The BN and other land grant railroads dispute this.

They want to reduce the great and enduring public trust vested in them to a sort of cash-and-carry bargain. One provision of the original land grants required the BN and the others to provide reduced-rate rail service to the government. The railroads now contend, in advertisements appearing in magazines and newspapers throughout the country, that by providing such service they have paid for their land grants ten times over.

Therefore, we are led to believe, they have no further obigations to the public in connection with these grants.

The BN itself asserted, in papers filed in a recent lawsuit in Seattle, that it now "holds these lands in fee like any other private party." In other words, it says it can now do whatever it pleases with those land grants. End of matter.

But that is not the end of the matter. It is only the beginning of our inquiry. Their claim is dubious. More important, it is utterly irrelevant.

FULL OF HOLES

The BN must be hoping that the people who read the indignant ads do not go back and read the Congressional studies and hearings from which they derive their claims. These are nothing short of shocking. Far from proving the railroads' case, they shoot it full of holes.

Let me mention just a few of the points that the railroads omit in arguing that they have paid for their land grants ten times over.

First, they totally omit the value of the timber, coal, oil, gas, and other resources on and under their land grants. Instead, they assume that these lands are just scrub prairie, nothing more. The Rockefeller family might just as will omit its stock and bond holdings from the value of its estate.

Perhaps we should offer to buy back the land grants for the value the railroads use in claiming they have repaid their land grants ten times over. I suspect that the railroads would quickly come forth with a somewhat higher appraisal.

Second, there is evidence that the allegedly "cut rates" the government received were not really cut rates at all. House testimony in 1944 by Mr. C. E. Childe, a member of the Board of Investigation and Research which investigated the "discount" rates provided by land grant railroads, suggested that instead, the railroads jacked up their "regular" rates and played other games with their rate structures, so that they could offer the government "discounts" and still turn a profit.

In any case, the alleged discounts couldn't have been too unprofitable. Why would the non-land grant railroads have been so eager for this government traffic, if it was really as unprofitable as they say?

Third, the land grant railroads didn't even provide all the service that they attribute to themselves in calculating that they paid for their land grants ten times over. Instead, they lump into their side of the ledger the allegedly reduced rates provided voluntarily by their non-land grant counterparts. In fact, according to Mr. Robert E. Webb, Chairman of the Board of Investigation and Review, these primarily-Eastern railroads contributed more cut rate service, than the land grant railroads did.

In short, it appears that the land grant railroads are taking credit for service provided by others.

Fourth, an investigation in 1948 found that the railroads had overcharged the federal government by 10-12% of their billings during the Second World War. This amounted to approximately $650 million for the three years '43, '44, and '45. I have found no evidence that the railroads ever paid back these overcharges in any meaningful way, or that they included it in their calculation that they have paid for the land grants ten times over.

OUR LAST OPPORTUNITY

It is clear that Congress has never gotten to the bottom of this matter. The finding in the 1940s that the railroads had paid off the grants rested on evidence that is less than convincing. As I have suggested above, very important questions remain.

We should answer these questions. The Burlington Northern is about to march off with a sizable portion of this nation's partrimony, on the basis of a claim that may well be false. If we do not investigate this question now, we may never have an opportunity to do so again.

There is a more important point. The claim that the railroads have paid back their land grants, is utterly irrelevant.

The railroad land grants were not a cash-and-carry deal. They were an enduring public trust, an endowment for the continuing support of railroad service. The requirement of cut rates for the government was but one provision of the grants. It was not the entire bargain.

Congress provided in Section Twenty of the BN's original land grant that it intended for this grant to help in "keeping (the railroad) in working order."

A Congressional Research Service study of this question, undertaken at the request of myself and other members of Congress, concluded that ". . . it appears both from the language of the Northern Pacific grants and the legislative history surrounding their enactment that Congress did envision a constructed and operating railroad as the purpose and result of the land grants."

This is the standard which we must hold the recipients of these land grants, including the Burlington Northern.

TAXPAYERS WILL PAY—TWICE

And this is why the Burlington Northern's move to set up a holding company is the business of every taxpayer in this country, as well as of every person who relies on the Burlington Northern railroad.

If the Burlington Northern retreats from railroad service, then the burden will fall on our taxpayers. They will be asked to subsidize rail service, to buy or maintain branch lines, or even to take over some rail operations entirely. They will be forced to pay for the highways and other facilities necessary to replace service that the Burlington Northern no longer offers.

Our nation needs this transportation service and someone will have to provide it.

American taxpayers have already payed for this service once. They have already bestowed upon the Burlington Northern an endowment so generous as to defy the imagination, to enable it to provide transportation that our nation needs. It simply is not fair to expect our taxpayers to pay a second time, while the Burlington Northern or any other railroad walks away with this endowment and converts it to its own private gain.

The Burlington Northern's holding company will lead us down that path.

We must act now.

Here are a few of the steps that we should take.

1. INVESTIGATION OF LAND GRANTS

It is time for a complete Congressional investigation of the land grant question. We need to know what the railroads have, how they are using those grants, and whether the original purpose of those grants is being served.

We also need to get to the bottom of the railroads' claim that they have repaid their land grants ten times over. We need to ask why the many questions surrounding this claim have been swept under the rug for so long.

2. REAFFIRM INTERSTATE COMMERCE COMMISSION JURISDICTION

True to form, the ICC has gone to great lengths to find reasons why it can't do anything about railroad holding companies.

It seems plain that existing law gives the ICC at least some authority in this area. Even the Commission's 1977 report on railroad holding companies suggested as much.

Given the Commission's recalcitrance, however, we should enact legislation that explicitly affirms the ICC's jurisdiction. The holding company device should not be an escape hatch by which the Burlington Northern and others can avoid their responsibility to keep the financial health of their railroads as their top corporate priority.

3. REVIEW TAX PROVISIONS THAT JEOPARDIZE RAIL SERVICE

Tax loopholes are one of the primary engines driving the wave of mergers and acquisitions in railroading and other businesses. We must eliminate these loopholes both to protect rail service and to promote competition and individual initiative in our entire economy.

We must look in particular at the way the railroads are using the billions of dollars in new tax breaks we gave them in last year's tax bill. The new reductions were so generous that the Burlington Northern is expected to pay no federal income tax at all this year. The purpose of those tax breaks was to promote investment in railroad operations. Instead, the Burlington Northern and others seem inclined to use their hundreds of millions in new breaks to help provide cash for other ventures.

In other words, the railroads are using their tax breaks just as they have used their land grants—to enlarge their empires, as much as to serve the public.

This is nothing new. After examining the records of at least seven railroad holding companies, the 1977 ICC Report concluded that "since there is no evidence that the holding companies have reinvested these tax savings in the carriers, the savings have been employed to finance diversification and other noncarrier activities of the holding companies."

We should make certain that the railroads use their tax breaks for the purpose for which they were intended.

FORFEITURE OF LAND GRANTS FOR RAIL LINE ABANDONMENTS

The purpose of the rail land grants was to support rail service. If the railroads are not going to provide that service, then they should give back a portion of the land grants that we gave them.

I have introduced a bill that would accomplish this. My bill, The Railroad Accountability Act of 1981, (H.R. 5114, 5115) would require the railroads to forfeit their land grants to a state, in the proportion that they abandon service in a state.

This Act would also require the railroads to include land grant income in their branch line balance sheets when trying to justify a branch line abandonment to the ICC. This would prevent the railroads from wearing a tattered cloth coat before the ICC when actually they are rolling in land grant cash.

Senator BAUCUS. Mr. Fogarty.

STATEMENT OF BILL FOGARTY, ADMINISTRATOR, TRANSPORTATION DIVISION, MONTANA DEPARTMENT OF COMMERCE

Mr. FOGARTY. Mr. Chairman, members of the committee, and guests, my name is Bill Fogarty. I am the administrator of the Division of Transportation, Montana Department of Commerce.

I appreciate the opportunity to testify before the committee today.

The Montana Department of Commerce and its Transportation Division provide the transportation nucleus for the State of Montana.

MONTANA TRANSPORTATION

First, I would like to give you a brief overview of the State of Montana and its relationship to its transportation system. Transportation has been and continues to be one of the single most vital links in the development of Montana's economic base. At the June 1981, meeting with the Governor's Ad Hoc Committee on Agriculture, farm organizations and agricultural leaders from all over the State agreed that transportation was the No. 1 problem confronting agriculture, the State's No. 1 industry. Montana's economy is basically agrarian based and extractive oriented.

The $1.5 billion in cash receipts from the marketing of agricultural products is the single largest contribution to Montana's general economy.

A large portion of this money is generated from commodities sold in the export markets.

Price competitiveness in the world market is critical to the maintenance and development of export markets. Outside of the cost of production, transportation is the single largest factor in determining the price of any Montana agricultural product destined for a foreign market.

During the 1980 grain market year, 95 million bushels of wheat with a value of $393.3 million was shipped out of the State.

Let us take a look at Montana's specific transportation conditions. Approximately one-half of Montana's wheat is produced in an area called the golden triangle, an area bounded by the points of Shelby, Great Falls, and Havre. Approximately one-fourth of Montana's wheat is grown in the northeast corner, an area shaped roughly as a square bounded by the points Glasgow, Bainville, Plentywood, and Opheim. The triangle wheat is mostly winter wheat, with the northeastern wheat being predominantly spring wheat. Approximately one-eighth to one-quarter of Montana's wheat is grown in and around the Stanford-Lewistown area, which is located in central Montana. Approximately 80 percent of the wheat produced in the State moves westbound, and 90 percent of that amount goes into export channels. It is obvious that we are an export-oriented State and depend on the world price for our product to have value to the State.

RAIL RATES

Traditionally, because of its dominant position, the BN has been able to maintain its transportation rates in Montana, at the break-even point of the truck/barge combination. The truck/barge combination is the only form of competition which the BN has in the movement of grain. Rail rates from Great Falls, Conrad, Shelby are at a level which will not encourage more than 10 to 15 percent of the wheat to go by truck to Lewiston, Idaho, and then down the Columbia River by barge to Portland. The railroad has traditionally allowed 10 to 15 percent of the grain to be trucked by competitors. However, when that level starts approaching 35, 40, or 45 percent, the railroad reacts by rate incentives and providing inducements to attract the grain back to the system. The railroad then prices its service at the truck/barge break-even point. It is a logical conclusion then that the truckers exist at the mercy of the railroad.

A most alarming threat to Montana grain marketing is that we could possibly become a marginal supplier of grain for export. Due to the high freight rates, the Midwestern States move their grain to west coast markets, and only then if there is still adequate world demand can Montana move its higher cost grain to the west coast for sale. Part of this problem is that Montana is faced with a lack of competitive transportation systems. The distances are long and the requirements to move bulk commodities are very real.

STAGGERS ACT

The passage of the Staggers Rail Act of 1980 partially deregulating the railroads was widely regarded by the business and investment communities as a great victory for free markets, free competition, and the free enterprise system. I submit to you that the actual consequences do not quite live up to initial expectations.

The Staggers Rail Act has resulted in increases of revenue and profits to the railroads, as it was intended to do, but the question is at what cost to the economy and the public interest. In Montana, the effects have been to lessen competition between and among the modes. Today the regulatory system is in shambles, and discriminatory pricing of rail service on captive traffic is the rule. It is important to note that the effects of deregulation have improved substantially the earnings of all railroads including the one serving our State.

HOLDING COMPANIES

The formation of a holding company by a railroad tends to separate from the carrier entity those assets which could serve to assist them in their providing of transportation services.

While advances to noncarrier affiliates, typically the parent holding company, may technically be characterized as an asset to the carriers, the realities of the business world and the search for greater rates of return in noncarrier investments indicate the usage of this asset may permanently be lost to the carrier. The fact that what goes up to the parent frequently does not flow back to the carrier concerns us. In light of the control exercised by a holding company over its subsidiaries, the Interstate Commerce Commission has advised Congress that special attention be given to the possibility of disinvestment of railroad capital or the direct or indirect transfer of public financial support, intended to strengthen the railroad transportation, to other economic interests in the conglomerate firm. The ICC has found that railroads, as subsidiaries of holding companies, are in danger of weakened financial strength resulting from the loss of previously available noncarrier income from investments and resources. In a study of holding companies, the ICC has explained that the loss of those assets sometimes diminishes current potential earnings of the affected railroads.

Our concern is that sometimes noncarrier resources have been diverted from railroads without adequate compensation. Railroads have been deprived of wealth accumulated over the years, including resources such as land grants which were acquired at the public expense. Ultimately, the removal of such assets has reduced the railroad's earning power.

LAND GRANTS

The Commission has characterized the transfer of land grants without adequate compensation as an abuse of the public interest. While there are many benefits to the formation of holding companies to the railroads, there could be many liabilities to the individual shippers.

The railroads making up the present BN received some 40 million acres, which accounts for about 35 percent of all the total Federal land granted to all railroads. The grants cover various portions of various States. In Montana approximately 16 percent of the total State was given to the railroads in the form of land grants. Approximately 24 percent of the land area of North Dakota was given to the railroads. The land grants noted above were in addition to the public lands conveyed for use in right-of-way construction itself and consisted of every odd-numbered section of land alternating in a checkerboard pattern on either side of the line being constructed, extending outwardly from the line from a minimum of 6 miles to a maximum of 50 miles. In the lands that were territories the land grant width allowed 50 miles on either side of the railroad line.

The purpose of my testimony today is not to debate the issue of whether land grants were proper but that land grants were given to the railroads, and that income and wealth generated from these grants should be revested back to the railroad system in order to lower the operating costs.

The revestment in the BN railroad of the land grant assets is a matter of immediate concern both to the economy of the grain industry and mineral producing areas of Montana. The exclusion of such income in determining a level of rates on the BN necessarily affects the competitive posture of all the modes. As the Commission found in the conglomerate report, in the hands of the nonholding company railroads, the income from the land grant assets is available for transportation purposes.

Montana sees the benefits of a holding company from the railroad standpoint. The benefits include such things as promoting better and more efficient utilization of the resources within the holding company and the ability of one of the subsidiary companies to ship on the railroad any coal or other resources that it develops. Conversely, the State is concerned that the creation of the holding company may present an opportunity to transfer some of the assets that were formerly with the railroad company to other subsidiaries and make them unavailable to the carrier in the future.

Montana is not assuming the right or wrong of any land-grant issues. What it is proposing is that some safeguards ought to be in place to insure the carrier company is not stripped of its assets that are properly part of it.

The important fact is that the holding company controls a large railroad system and that regulation is in the public interest and should be the ICC's responsibility.

We are also concerned with the ability of railroads to serve the heart of the State's economy. The county elevator is a prime example. Beginning with the implementation of the unit train grain rates in December 1980, Montana grain marketing system is reflecting major changes. Smaller elevators lack moneys to switch to the larger transportation efficient grain subterminal. While rate negotiations are continuing with the railroad, it is evident that, if they are purely concerned with profit and not public interest, they have the capability to cause widespread economic dislocation. Some competitive carriers have more rate options including three-car rate. The State of Montana believes that it is in the best interest of the State's economy to keep the 26-car unit train rates within 3 to 4 cents of the 52-car unit train rates to lessen the severity of the economic impacts on the State's economy, our highway systems, and the grain marketing systems.

I appreciate the opportunity to testify.

Senator **Baucus**. Thank you very much.

As I understand you, you are basically saying you feel that land-grant assets should be used to promote rail service and that formation of holding companies can harm rail shippers. I am wondering if you have any specific proposals or ideas that would help insure that holding company transactions are properly monitored by the ICC, that is whether the ICC can accomplish this task with its present 2- to 3-year audits or whether something more is needed in order to determine whether the land-grant assets actually do help promote rail service in the case of a holding company.

Mr. **Fogarty**. Mr. Chairman, we definitely feel that the ICC should maintain the jurisdiction and keep a close monitoring power over the actions of holding companies, particularly as it pertains to the possible moving of assets away from the railroad.

Senator **Baucus**. Would you propose any examination procedures or any kind of additional proposals that the ICC should undertake in order to determine that?

Mr. **Fogarty**. Yes. The only thing that came to our attention just a short time ago, as I understand it, there was a ruling made that the Burlington Northern no longer has to in their annual report define the cash flow of their line companies. We feel that this would be an aid in insuring that the assets from the land grants are returning to the railroads in the proper form.

Senator **Baucus**. We have lots of witnesses here. Our time is running on. Do you have any other comments that you want to make, Mr. Williams?

Mr. **Williams**. No, Senator.

Senator **Baucus**. Thank you both very much.

Our next witness is Mr. William Baxter, Assistant Attorney General for the Antitrust Division of the Justice Department.

General, I appreciate your coming today. I know you are a very busy man.

Without objection, your prepared statement will be inserted into the record.

As you know, I have been somewhat concerned about the lack of competition now in rail service in Montana, particularly with the demise of the Milwaukee. As you proceed, I would appreciate it if you keep that in mind. Maybe you can address that point as best you can. I appreciate your coming today and please proceed.

STATEMENT OF WILLIAM F. BAXTER, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE, ACCOMPANIED BY ELLIOTT M. SEIDEN, CHIEF, TRANSPORTATION SECTION, ANTITRUST DIVISION

Mr. **Baxter**. Thank you, Senator.

I have submitted a formal statement which reviews the activities of the Antitrust Division and our practices with respect to rail mergers. As you know, applications to consummate rail mergers are submitted to the Interstate Commerce Commission. They are not covered by the antitrust laws. We do not receive the kind of data that we would normally receive through Hart-Scott-Rodino filings. Rather, we receive a copy of the application. The statutes provide that we may intervene, and we often do, in rail merger situations. Then, of course, we have the benefit of the filings that the companies and intervenors may make. It is through that procedural vehicle that we review the consistency with antitrust policy of any particular rail merger.

We do not, of course, have final say. Our position is one of arguing our point of view on the competitive aspects to the ICC. But we do have statutory appeal authority. There have been occasions when we have used that.

Rail mergers can be categorized roughly into those mergers which are primarily end-to-end and those mergers which are primarily parallel. Those categories, in a very rough sense, correspond to two antitrust categories, to which I have often addressed myself: horizontal and vertical arrangements. parallel rail mergers correspond roughly to arrangements that antitrust lawyers would think of as horizontal and end-to-end mergers correspond roughly to arrangements that we would think of as vertical.

End-to-end rail mergers are somewhat more likely than most industrial vertical arrangements to give rise to problems, however, because an end-to-end rail merger can give rise to a diminution of what we sometimes call source competition or market competition. The typical situation would be where each of the two railroads carries widgets and is the only source of widgets to the point where they meet end to end. Under those circumstances, essentially, the competition between the two roads and in providing widgets at the point of junction might be significantly lessened even by an end-to-end merger so that there is no assurance that an end-to-end merger will not lessen competition. But, more typically, the mergers that are substantially parallel do so.

The Antitrust Division and the Interstate Commerce Commission over the years have not always seen eye to eye on the competitive aspects of rail mergers. The merger that is of focus here today was one of those where we did not agree. The BN was formed by a merger among the Northern Pacific, the Great Northern Railway, and the Chicago Quincy & Burlington. The first two of those railroads were, of course, the principal northern tier carriers, and the merger between them eliminated a very substantial amount of competition. We opposed that rail merger and, indeed, appealed its approval by the Commission but were unsuccessful.

The Commission's approach in that case, as it has been in a number of cases, was to attempt to use the desirability of the merger to the parties in an effort to strengthen other carriers, sometimes competitive carriers but sometimes carriers which, in the view of the Commission, just needed strengthening and perhaps to cure problems that had nothing to do with the merger at all. We have long thought that was an unwise way to use so-called protective conditions. We were delighted when the Commission very recently announced that not only would it no longer impose conditions of that kind in rail mergers, but that it would review conditions previously imposed under those circumstances. We think that is a highly desirable development.

In the particular case of the northern lines merger, the ICC imposed several conditions that were intended to strengthen the Milwaukee Road and turn the Milwaukee Road into an effective northern tier carrier. In the very short run, they were successful. They provided a through connection to the west coast and to the Canadian railways in the Far Northwest for the Milwaukee which it had not previously had. The Milwaukee's traffic did, as a result, pick up for awhile. But the Milwaukee had been so undermaintained over the years and it was so financially weakened that it really could not take advantage of the additional traffic effectively. There were very slow speed restrictions on a very large part of its roadbed which was badly deteriorated. In a development which, I think, should not have come as a great surprise to anyone, the Milwaukee went into bankruptcy and ceased to be an effective competitor, leaving us with the unfortunate situation that the two strong roads are now merged and do have a position of substantial market power across the northern tier.

All of that, as I say, occurred over the very vocal protest of the Antitrust Division.

At a subsequent point in time, I believe in January of 1980, we first received complaints to the effect that the condition of the Milwaukee was being impaired by conduct of the Burlington Northern in violation of the protective conditions that the ICC had imposed. We investigated those complaints very, very thoroughly. We sought and received enormous quantities of documents both from the BN and from the Milwaukee. Thousands of documents were brought back to Washington and studied very, very carefully by the Division.

The result of that investigation, I have to tell you, was that, although we found a few isolated instances where one could argue that there had been a technical violation of the protective conditions, there did not seem to be any systematic or deliberate pattern. Rather, the pattern, seemed to be one of careful compliance with the conditions. The violations which we were able to find were limited to a handful of instances, and were technical in their nature. It was very, very clear that the instances of violation had no causal relation to the failure of the Milwaukee. Accordingly, that investigation was closed in December of 1981.

That is where we are today, Mr. Chairman, with respect to the BN. I would be happy to elaborate on any points in my statement that are of interest to you or to answer other questions that you may have.

I have brought my expert with me, Mr. Elliott Seiden. I do not purport to be an expert on rail mergers. I am sure that between the two of us we will give a good shot at answering such questions as you may have.

Senator BAUCUS. Thank you very much, Mr. Baxter. You in your statement very briefly touched upon the difference between end-to-end mergers and parallel mergers. I am wondering whether you see any more parallel mergers occurring in the future or are they a thing of the past?

Mr. BAXTER. I think it would be rash to say that they are a thing of the past. One would not want to stop all parallel mergers. Indeed, most mergers have some parallel aspects and some end-to-end aspects. Quite frequently a merger which has some parallel aspects will nevertheless give rise to very substantial efficiencies. The difficulties, the anticompetitive features can largely be removed by giving other parallel carriers trackage rights with other arrangements of that type.

I do not mean to suggest we have seen the last of railway mergers with parallel features.

Senator **Baucus**. Do you tend to see more end to end in the future than parallel?

Mr. **Baxter**. I really do not have enough information to make a pronouncement on that. Let me see if Elliott would like to comment on that.

Mr. **Seiden**. Mr. Chairman, it certainly seems to be the trend that we have seen in the last several years. The trend has been away from parallel mergers. There have been some notable parallel merger attempts that have not been particularly successful, most notably the Penn Central. The trend has been, throughout the seventies, after the northern lines case for the rail companies to look at end-to-end mergers, not parallel ones. Whether that trend will continue remains to be seen. But, based on the experience of the last 12 years at least, the trend seems to be away from rail companies looking at parallel mergers.

Senator **Baucus**. I am interested in what the Department's policy is or ability is to study the after-effects of merged railroads. Could you describe the Department's review procedures of merged railroad performance?

Mr. **Baxter**. We have no active program of studying postmerger behavior or the economic consequences of rail mergers. We will study the proposed merger very carefully, take a position on the proposed merger; but, if the merger goes through, we at that point would not continue to make any systematic observation of the behavior of the parties unless some reason was brought to our attention why we should believe that a new violation of the antitrust laws, which might take the form of a violation of protective conditions, was occurring. In the case of the BN, for example, if we had found a systematic and deliberate violation of the protective conditions, that behavior might well itself have constituted an attempt to monopolize within the meaning of section 2 of the Sherman Act. Then, of course, we would have brought a case to bring that conduct to a halt.

Senator **Baucus**. Do you think that either the Department or the Commission should conduct a greater postmerger analysis? Do you think it would be beneficial or not?

Mr. **Baxter**. Senator, I am unable to tell you how carefully the Commission observes postmerger behavior or the quantity of resources the Commission puts into that effort. As a consequence, I would have no basis for forming an opinion whether the Government in some aggregate sense should be devoting more resources to that than it is. But we devote essentially no resources.

Senator **Baucus**. Is the information that is provided to the Department in a merger application sufficient? You mentioned you do not get the Hart-Scott-Rodino information. Does the Department feel it should have more information?

Mr. **Baxter**. The information we receive in the application quite often would not itself be totally sufficient to enable us to form a final judgment, but it is enough to let us form a preliminary judgment. Then we have the benefit of additional information during the course of the proceedings, the information contained in filings by parties. So, the procedure, taken as a whole, we do not view as inadequate, given the starting premise that rail mergers should be exempted from the Sherman Act, and left in the hands of the Commission to be judged in accordance with its rather vague public interest standard. On prior occasions the Antitrust Division has testified that rail mergers should be taken out from under the ICC and subjected to section 7 of the Clayton Act like any other merger. I have not reviewed that point of view recently but I know that that is a point of view the Antitrust Division has taken in the past.

Assuming that rail mergers are essentially to be left with the ICC, we see no substantial procedural defects of the present mechanism.

Senator **Baucus**. For the record, what kind of information would be available, the kind of information if the Hart-Scott-Rodino application were furnished? I would like just a brief summary of what additional information that would entail.

Mr. **Baxter**. In a Hart-Scott-Rodino filing, we get a fair amount of information about the company, the nature of its activities, the volume of its activities in various markets.

I do not mean to suggest that the initial Hart-Scott-Rodino filing traditionally gives us enough information to reach final judgments on mergers. What is significant about the Hart-Scott-Rodino approach is that it affords us an opportunity to make a further request for information after we have had an initial burst of information that enables us to form tentative judgments about where problems are likely to show up.

I simply intended to point out that the procedures here are quite different than with most industrial mergers.

Senator **Baucus**. With the recent Department budget cutbacks, I am curious how much your rail merger staff has been cut back in the last couple of years and what anticipated levels you see in staff in this category.

Mr. **Baxter**. We have taken the reductions pretty much evenly across the board. Mr. Seiden's section is likely to have lost one or perhaps two lawyers. Elliott?

Mr. **Seiden**. Not yet.

Mr. **Baxter**. He is doing well.

Senator **Baucus**. Could you tell me how many professional staff has your shop lost, Mr. Seiden?

Mr. **Seiden**. Presently, the Transportation Section is composed of 24 staff attorneys, a chief and an assistant chief, for a total of 26 attorneys, and approximately 16 support people, including paralegals and secretaries. The section has over the last 4 years or so been right around the 40-person level, and it is there now.

Senator **Baucus**. Do you feel you have sufficient personnel in this area?

Mr. **Baxter**. Yes, I do, Senator. I would also add to Mr. Seiden's statement that Transportation, like the other sections of the Antitrust Division, has access to our staff of economists. We work very closely with some economists who are specialized experts in transportation matters. So, we have that resource as well.

I do not feel that the present level of budget or staffing at the Antitrust Division is impairing our effectiveness.

Senator BAUCUS. I think in your prepared statement you mentioned that the Department spent 2,500 hours and $40,000 on the 1980 BN antitrust investigation. Is that correct?

Mr. BAXTER. I believe those are the correct numbers for investigating the possible violation of these protective conditions.

Senator BAUCUS. Do you feel that was sufficient to review several hundred thousand documents that were handled in this investigation?

Mr. BAXTER. Well, again all I can tell you is that I did not hear Mr. Seiden complaining. If he had felt that he needed to do more, I suspect he would have done more.

Senator BAUCUS. Are you complaining, Mr. Seiden? Or did you complain?

Mr. SEIDEN. No, Senator. I am quite confident that the investigation conducted in my section was quite thorough and that all of the relevant documents were read. They were all carefully and thoroughly reviewed and digested. The final recommendation was based on a careful analysis of all the information.

Senator BAUCUS. Who closed the investigation? As you mentioned, it was closed in December of 1981.

Who makes that decision? Who basically closes it?

Mr. BAXTER. I'm sorry?

Senator BAUCUS. I am curious. Who——.

Mr. BAXTER. As a formal matter, the instructions to close an investigation come out of the Office of Operations. The extent to which I or one of my deputies would be involved in an investigation before it was actually closed would vary from case to case depending on the significance of the matter.

Senator BAUCUS. Your testimony this morning gave us the Department's conclusion of that study. I appreciate that very much. I am wondering if for the record you could provide us with a somewhat more complete statement of the Department's findings with respect to that investigation. Could you do that please? [1]

Mr. BAXTER. I am sure we can give you a description of some sort.

Senator BAUCUS. I appreciate that very much. I really would.

I also agree with your conclusion, if I correctly understand your conclusion that it is unfortunate that the northern tier no longer has competitive rail service. Do you see any possible solution of that predicament. Or, in your judgment, are we simply compelled to live with what you describe as the adverse effects of ICC approving that 1970 BN merger?

Mr. BAXTER. Once a merger has been consummated and the two operating plants have been integrated, it is not atypically quite difficult, expensive, and sometimes counterproductive to try to take them apart even if they ought not to have been originally merged. I certainly do not have the information that would enable me to say whether that is a reversible transaction as of this point in time.

I also think that the law is not crystal clear on whether the ICC would have jurisdiction to revisit that question. That, too, would require further research.

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[1] See page 602 in the appendix for letter from Mr. Baxter to Senator Baucus.

Senator BAUCUS. In your prepared testimony you also stated that you see great dangers in granting regulatory agencies the authority to immunize mergers from the antitrust laws.

I am wondering whether you have any proposed changes in the law at this time in order to address that problem.

Mr. BAXTER. No, I have no proposal that I am prepared to advance this morning, Mr. Chairman. I would point out that at prior points in time the Antitrust Division has suggested removing rail mergers from the jurisdiction of the Commission and treating them like other industrial mergers. But, as I indicated earlier, I have not currently reviewed that proposition. I point to it, but at this time I am not prepared personally to endorse it.

Senator BAUCUS. I do not know if you were here, but earlier Senator Melcher indicated that the ICC has no control over contract rates. Does the department have sufficient authority and staff to insure that contract rates are not made available to BN's affiliates in a discriminatory manner?

Mr. BAXTER. Because contract rates have been deregulated—I am going to ask Mr. Seiden to deal with that. The precise timing on the deregulation effected by the Staggers Act and the removal of antitrust immunity I do not have in the top of my head, and I suspect he does.

Mr. SEIDEN. Senator, if I understand your precise question, the question is whether we think the Department of Justice has sufficient staff to look into a possible anticompetitive effect resulting from contract rates.

Senator BAUCUS. And authority.

Mr. SEIDEN [continuing]. And authority.

Yes, I think that contract rates presently are not subject to any outstanding order or provision by the ICC conferring antitrust immunity over them so that they are presently exposed to the full force and effect of the antitrust laws. Whether we have sufficient staff to enforce the antitrust laws, I think the answer is yes, we do. If certain conduct came to our attention suggesting antitrust——

Senator BAUCUS. I asked in part with respect to staff because, as I understand it, there are thousands of contract rates. There are not a few but there are many. I am wondering whether that might cause some staff problems down the line.

Mr. SEIDEN. I think implicit in your question, Senator, is some suggestion that perhaps there ought to be a review of each and every one of those thousands of contract rates. My feeling is there probably is no need for that. There are millions, billions I suppose, of pricing transactions throughout the economy every day. I do not think anyone suggests that we or any other agency should be reviewing those on a price-by-price basis.

Senator BAUCUS. I want to thank you both very much for coming, particularly you, Mr. Baxter. You have been very helpful. I want to thank you very much.

Mr. BAXTER. Thank you, Senator.

[Prepared statement follows:]

STATEMENT

of

WILLIAM F. BAXTER
ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

Mr. Chairman and members of the Committee, I am pleased that you have invited me to participate in your inquiry into railroad merger policy. Since efficient and competitive rail transportation is vital to many basic industries, the topic of today's hearing well deserves your attention.

In my remarks today I would like to address two general topics: First, the Justice Department's policy and procedures regarding rail mergers, and, secondly, the Department's role in the so-called Northern Lines Merger--the railroad consolidation that created the Burlington Northern.

1. Department of Justice Rail Merger Policy and Procedures

As you know, mergers between railroads are subject to the review of the Interstate Commerce Commission. The Interstate Commerce Act requires the Commission to approve and authorize a railroad consolidation, merger, or acquisition of control "when it finds that the transaction is consistent with the public interest."*/ As part of its public interest analysis, the Commission must, among other factors, consider the competitive effects of the proposed transaction. **/ In order to help the ICC make this determination, Congress explicitly gave the Department of Justice a statutory right of intervention in such proceedings and made special provision for the Attorney General to file preliminary comments with the ICC concerning proposed rail mergers. */ Pursuant to these provisions, the Department of Justice frequently intervenes in ICC rail merger proceedings.

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*/ 49 U.S.C. §11344(c).

**/ 49 U.S.C. §11344(b)(5). Port of Portland v. United States, 408 U.S. 811, 841 (1972); McLean Trucking Co. v. United States, 321 U.S. 67, 87 (1944).

In preparing our comments to the ICC concerning the competitive impact of a proposed railroad consolidation, the Department is essentially guided by the provisions of Section 7 of the Clayton Act. **/ Although, as I have mentioned, this statute does not directly apply to railroad mergers, it provides a useful and appropriate frame of reference for analyzing the competitive effects of a proposed railroad consolidation.

In using this approach the Department examines two different competitive aspects of rail mergers: a "parallel" or "horizontal" aspect and an "end-to-end" or "vertical" aspect. A rail merger can be characterized as parallel insofar as the merger partners offer competing transportation services between the same origins and destinations. In contrast, a merger can be regarded as end-to-end insofar as the merger partners serve common points, but do not serve those points from the same origin or destination. Most rail mergers have both types of competitive features, but usually it is possible to describe a proposed merger as being either primarily parallel or primarily end-to-end.

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*/ 49 U.S.C. §11345(b).

**/ 15 U.S.C. §18.

As a general rule, it is the policy of the Department of Justice to oppose ICC approval of proposed parallel rail consolidations since such consolidations frequently significantly reduce competition in transportation markets. It sometimes occurs, however, that the parallel features of a proposed rail merger are a relatively minor part of the transaction. In such cases we might not oppose approval of the merger if adequate conditions can be imposed by the Commission to reduce or eliminate the competitive problem. Such conditions, for example, might involve divestiture by the consolidating carriers of parallel rail facilities or requiring the merger partners to grant other railroads the right to provide service over the tracks of the merged carrier ("trackage rights").

In contrast, the Department does not generally oppose rail mergers insofar as they can be characterized as end-to-end. End-to-end mergers usually lead to efficiencies and do not have significant anticompetitive effects. It is conceivable, however, that in some circumstances the Department might oppose an end-to-end merger. For example, we would consider opposing an end-to-end merger if it would substantially lessen so-called "source" competition, e.g., competition between railroads carrying the same product to the same destination, but from different origins.

In concluding my description of the Department's policy regarding railroad mergers, I wish to briefly discuss so-called "protective - conditions." Protective conditions are requirements that the ICC imposes in merger proceedings in order to protect the financial interests of the railroads that are not included in the proposed consolidation. Typically, this is accomplished by requiring the merging railroads to conduct at least some part of their operations following the merger in the same manner as they did prior to the merger. In a recent decision, the Interstate Commerce Commission indicated that it now views such protective conditions as generally undesirable and announced that it will no longer routinely impose them. */ The Commission's decision, we believe, is a wise one. When protective conditions are imposed, merging railroads are frequently prevented from achieving operational efficiencies, and, at the same time, are precluded from fully competing with the beneficiaries of the protective conditions.

The procedure followed by the Department of Justice in reviewing major railroad mergers is somewhat different from the

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*/ Rulemaking Concerning Traffic Protective Conditions in Railroad Consolidation Proceedings, Ex Parte No. 282 (Sub No. 5), 366 I.C.C. 112 (1982).

procedures we follow in considering other types of mergers. Because rail mergers are subject to the exclusive jurisidiction of the Interstate Commerce Commission, the parties to a proposed railroad merger are not required to give us the same kind of advance information as we are entitled to receive under the terms of the Hart-Scott-Rodino Act of 1976 concerning other major consolidations. */ Instead, we receive a copy of the merger application filed with the ICC.

Under a provision of the Interstate Commerce Act, the Department is also entitled to receive a copy of all public comments filed with the ICC concerning a proposed merger, and we have 15 days after receipt of these comments in which to intervene in the ICC's proceeding. **/ At the time it intervenes, the Department is required only to state its preliminary views, and is not usually required to state a final position on a merger proposal until the evidentiary phase of the Commission's hearing is complete. In almost every case in which the Department files preliminary comments, we also participate as a party in the Commission's evidentiary hearing, and we frequently present expert witnesses from the Antitrust Division's Economic Policy Office. If the Department believes the decision of the Commission regarding a particular merger proposal is contrary to the terms of the Interstate Commerce Act, we have the right to appeal that decision to the federal courts.

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*/ P.L. 94-435, 15 U.S.C. §18a.

**/ 49 U.S.C. §11345(b).

2. The Northern Lines Merger

Let me now briefly summarize for you the Department's role in the merger that created the Burlington Northern and our subsequent investigation of the Burlington Northern's compliance with the conditions imposed on that merger by the ICC.

As you may know, in 1970 the so-called "Northern Lines" merger combined three railroads that served the Midwest and Northern Tier states: */ the Great Northern (GN), the Northern Pacific (NP), and the Chicago, Burlington and Quincy (CB&Q). From a competitive perspective, the merger's parallel element was the most important since two of the railroads, the Great Northern and the Northern Pacific, had parallel tracks across the Northern Tier and were therefore direct competitors.**/ It was primarily for this reason that the Department of Justice vigorously opposed the merger, and appealed the Commission's decision approving the merger all the way to the Supreme Court.***/

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*/ Minnesota, North Dakota, Montana, Idaho, and Washington.

**/ In contrast, the merger's end-to-end feature--the inclusion in the consolidation of the CB&Q--was substantially less important.

***/ United States v. Interstate Commerce Commission, 396 U.S. 491 (1970).

Probably the most important issue before the ICC and the courts as they reviewed the merger was whether or not the only remaining railroad providing service on the Northern Tier, the financially-weak Chicago, Milwaukee, St. Paul and Pacific Railroad (the "Milwaukee"), would be able to provide sufficient competition to the new Burlington Northern. One of the ways that the Commission chose to confront this issue was to impose certain conditions on the merger that were intended to make the Milwaukee a stronger competitor. The Department argued that these conditions were inadequate to cure the merger's anticompetitive effects, but our arguments were rejected at both the ICC and the Supreme Court. **/

As many of you know, within a few years following the merger the Milwaukee found itself unable to compete effectively with the Burlington Northern. In December 1977, Milwaukee filed a petition in bankruptcy and its operations were taken over by a bankruptcy trustee. Subsequently, the trustee found it necessary to terminate many of the Milwaukee's services including, most importantly, the service to the Pacific coast that was supposed to provide a competitive check on the Burlington Northern. As a result, the Burlington Northern is today the only carrier providing rail service in a large number of transportation markets in the northwestern United States.

**/ 396 U.S. 516. See also Great Northern Pacific & Burlington Lines Inc.--Merger-etc.--Great Northern Ry et al., 331 I.C.C. 228, 275 (1967).

Despite the fact that we were unsuccessful in persuading the ICC to disapprove the Northern Lines merger, the Department of Justice has had occasion to inquire into whether the Burlington Northern adhered to the conditions that the ICC had imposed on the merger in an attempt to reduce its anticompetitive impact. In the early part of 1980, we learned of accusations that the Burlington Northern had deliberately contributed to the bankruptcy of the Milwaukee by, among other things, intentionally violating certain ICC-imposed merger conditions. These conditions essentially (1) opened eleven gateways on the Northern Tier on a reciprocal basis, */ (2) granted the Milwaukee certain trackage rights in the states of Washington and Oregon, **/ (3) required the BN to handle the Milwaukee's movements in and out of Billings, Montana, and (4) prohibited the BN and the Milwaukee from imposing "dual basis" switching charges at their common service points. ***/

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*/ This condition gave shippers the option of having their shipments interchanged between the BN and the Milwaukee at any one of eleven points without paying extra charges.

**/ These trackage rights were designed to give the Milwaukee direct access to Portland, Oregon, and to Sumas, Washington, an important point of interchange with the Canadian rail system.

***/ See Great Northern Pacific & Burlington Lines, Inc.-Merger, etc.--Great Northern Railway Co. et al., 331 I.C.C. 228, 356-58 (1967). Although the Department regarded these conditions as procompetitive, we felt, as previously noted, that their impact would be insufficient to offset the merger's anticompetitive effects. Id. at 275. These particular conditions are now largely moot because the Milwaukee has recently abandoned service at most of the locations to which they applied.

If the BN systematically violated these conditions to harm the Milwaukee, such conduct could well have constituted a violation of the prohibition against monopolization found in Section 2 of the Sherman Act. */ Accordingly, upon learning of these accusations, the Department opened a civil investigation into the competitive conduct of the Burlington Northern.

In the course of this investigation, we sent Civil Investigative Demands (CID's) to both the Burlington Northern and the Milwaukee calling for the production of a substantial number of documents. Burlington Northern alone produced several hundred thousand documents in response to our CID. Two Department attorneys travelled to the headquarters of the Burlington Northern and the Milwaukee to inspect these documents. The attorneys reviewed all these documents and requested that over 15,000 Milwaukee documents and 35,000 BN documents be sent to Washington for the staff's further inspection. In addition, Department attorneys interviewed shippers, former Milwaukee employees and former Burlington Northern employees to gather evidence relating to the Burlington Northern's conduct. Overall, the Department's records show that employees of the Antitrust Division spent approximately 2500 hours working on this matter and that the total cost of the investigation to the government was nearly $40,000. Both the Burlington Northern and the Milwaukee fully cooperated in the investigation.

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*/ 15 U.S.C. §2.

In December 1981, approximately 18 months after the investigation began, staff attorneys assigned to this matter recommended that the investigation be closed. It was their conclusion that there was no evidence of an intent by the Burlington Northern to eliminate or handicap the Milwaukee as a competitor. While the staff did conclude that the Burlington Northern competed vigorously with the Milwaukee, they found no evidence that this competition was predatory or otherwise illegal. In making its recommendation, the staff also noted that although there were a handful of isolated instances where the Burlington Northern might have arguably committed minor violations of some of the merger conditions, the impact of any such violations on the Milwaukee was de minimis. The staff attorneys also observed that although some of the blame for the Milwaukee's collapse can be traced to the fact that the Northern Lines merger put the Burlington Northern in a superior competitive position, the merger was granted antitrust immunity by the ICC and cannot now be used as a basis for commencing an antitrust suit against Burlington Northern. On the basis of these conclusions, on December 16, 1981, in accordance with normal procedures the investigation was closed.

The Department finds it particularly unfortunate that the Northern Tier states are no longer served by competing railroads. The reason for this unfortunate occurence, however, is not illegal conduct by the Burlington Northern. Rather, the basic cause was the Interstate Commerce Commission's decision to approve the Northern Lines merger. Of course, even if this merger had not been allowed, the Milwaukee still might have been forced into bankruptcy and required to abandon its western lines. However, if there had been no Northern Lines merger, there would today be at least two other carriers on the Northern Tier: the Northern Pacific and the Great Northern. The lesson to be learned from this experience, I believe, is that there are great dangers in granting regulatory agencies the authority to immunize mergers from the antitrust laws based on vague notions of the "public interest." Accordingly, I believe it appropriate to consider whether mergers in regulated industries should continue to be subject to review by such agencies under existing statutory requirements.

Mr. Chairman, this completes my prepared testimony. I would be happy to answer any questions from the members of the Committee.

Senator BAUCUS. Our next witnesses appear as a panel. Mr. Oliver Krueger is Associate Director of the Community and Economic Development Division of the GAO. Mr. Reese Taylor, Jr., is Chairman of the Interstate Commerce Commission. Their testimony deals with the monitoring of rail mergers and holding companies, a matter that I think takes us to the heart of the issues that we are addressing today. Chairman Taylor and Mr. Krueger, I welcome you both to this hearing. Mr. Krueger, why don't you proceed first.

STATEMENTS OF A PANEL CONSISTING OF OLIVER W. KRUEGER, ASSOCIATE DIRECTOR, COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY BOB CRYSTAL, GENERAL COUNSEL'S OFFICE, GAO, AND JAMES BLUME, GAO; AND HON. REESE H. TAYLOR, JR., CHAIRMAN, INTERSTATE COMMERCE COMMISSION, ACCOMPANIED BY LOUIS E. GITOMER, ACTING DEPUTY DIRECTOR, SECTION OF FINANCE, ICC; JANICE ROSENAK, LEGISLATIVE COUNSEL, ICC; AND WILLIAM MOSS, BUREAU OF ACCOUNTS, ICC

Mr. KRUEGER. Thank you, Mr. Chairman.

I have with me this morning Mr. James Blume of the General Accounting Office, who is really in charge of most of GAO's work at ICC. I also have Mr. Bob Crystal at the far right, who is an attorney from our General Counsel's Office.

We have submitted our full statement for the record. I have a short statement that I would like to read with your permission.

Senator BAUCUS. That would be fine. In fact, that would be great.

Mr. KRUEGER. We are here today at your request to discuss the Interstate Commerce Commission's jurisdiction over and monitoring of railroad companies, including the acquisition of the Burlington Northern Railroad by a holding company, ICC's ability to review merger applications despite staff reductions, and ICC's preparation and use of postmerger studies.

Under the Interstate Commerce Act, ICC does not have jurisdiction over the acquisition of a single rail carrier by a noncarrier, such as a holding company. ICC's jurisdiction applies only when a holding company is acquiring control of at least two carriers, or where a holding company already controls one carrier and seeks to acquire another. ICC has ruled that a rail system comprised of a number of rail carriers but operated and managed as a single system would be considered a single carrier, called the single system doctrine.

ICC applied the single system doctrine when deciding that it did not have jurisdiction over Burlington Northern's creation of a holding company in 1981. The holding company was formed to own both transportation and nontransportation companies and assets.

ICC was requested to exert its jurisdiction over the proposed holding company on the basis that it did involve the acquisition of at least two carriers. In its June 5, 1981, decision however, ICC denied the petitions stating that Burlington Northern's formation of a holding company met the single system doctrine.

Subsequently, ICC's decision was appealed and in February 1982, the U.S. court of appeals upheld the single system doctrine. The court stated that ICC's interpretation was not necessarily the one the court would adopt but that it was not unreasonable.

ICC also determined that its approval was not required for the proposed merger of the Colorado and Southern Railway Co. with the Burlington Northern Railroad. ICC decided this merger was exempt from its jurisdiction because it was within the corporate family. This is also consistent with ICC's single system doctrine.

In a 1977 report to the Congress, ICC stated that the opportunity exists for holding companies to make use of the railroads' assets to the possible detriment of the railroads. ICC's report indicated that it would conduct audits of rail carriers' records to identify transactions which might have a significant adverse impact upon the railroad.

ICC's activities in this area, however, appear limited. It monitors holding company railroad-related transactions through audits of railroad records and reviews of accounting and security reports. However, the audits of railroad records are only conducted every 2 to 3 years. In addition, the accounting and securities reports do not provide sufficient information to identify many of the holding companies' railroad-related transactions.

ICC officials told us that they do not monitor all holding companies' rail-related operations because of staff limitations, the redirection of policy toward less regulation, and the fact that no abuses have been identified under the current monitoring system. ICC officials also stated that, even if an abuse was identified, they believe that they do not have the authority to terminate or restrict the transaction because the single carrier holding companies are exempt from their jurisdiction.

We believe that ICC needs to monitor all holding companies' rail-related operations because the opportunity for abuse does exist. It needs to monitor such transactions to identify possible abuses in sufficient time to take appropriate action, including asking the Congress to increase its authority, if necessary.

In the area of staff reductions, ICC's overall staff has decreased by 512, or about 25 percent, since fiscal year 1979. The ICC office responsible for assisting in its merger analysis has been reduced from 92 to 52 since 1979. However, despite the staff reductions, ICC officials believe that sufficient staff exists to adequately review proposed mergers primarily because the staff from several of their offices actually assist in analyzing mergers, a number of the office's duties have been recently reduced or eliminated, and the number of major merger cases which require a full review is limited.

The director of that office, however, said that, if the ICC becomes unexpectedly flooded with merger proposals, it would contract out for specific studies rather than compromise the quality of its work.

Dealing with postmerger studies is my next subject. During Senate hearings in June 1979, before the subcommittee on antitrust, monopoly, and business rights, former ICC Chairman O'Neal testified that ICC was responsible for analyzing postmerger data and that it was in the process of contracting for such a study with Princeton University.

Senator, in response to your request, we inquired in November 1981 whether that study referred to by the Chairman had actually been done. ICC informed us that the study had not been performed and we relayed this information to you by letter dated December 2, 1981. Subsequently, ICC said that in spite of its earlier statements to us, it had found the study, which it then made available.

That study, however, did not accomplish ICC's original goals of determining whether the benefits of the mergers reviewed were realized nor provided information that could be projected to other mergers. According to the official responsible for the study, the scope was reduced because of data limitations.

ICC officials acknowledge that properly conducted postmerger studies may provide useful information for developing its merger policies. However, because mergers are not similar, they question whether the results from a completed merger can be used to assess the potential impact of a proposed merger. They also question whether such a study can produce conclusive findings.

Attorneys in ICC's Office of Proceedings stated that postmerger studies could be submitted as evidence during current merger proceedings. Since each merger is different, however, evidence from postmerger studies could easily be challenged on the grounds that the mergers were not sufficiently similar for comparison.

We believe postmerger studies could assist ICC's reviews of proposed mergers, either by developing methods for data analysis or by highlighting policy issues. However, any benefit to be derived from postmerger studies must be weighed against their cost and the possibility that the studies may not produce usable results.

Mr. Chairman, this concludes my short statement.

Senator **Baucus**. Thank you very much, Mr. Krueger. Before I ask you some questions, I would like now to proceed to Chairman Taylor.

Without objection, we will insert Mr. Krueger's prepared statement.

[Material referred to follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
EXPECTED AT 9:30 A.M.
FRIDAY, MARCH 26, 1982

STATEMENT OF
OLIVER W. KRUEGER, ASSOCIATE DIRECTOR
COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION
BEFORE THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
ON
THE INTERSTATE COMMERCE COMMISSION'S JURISDICTION OVER
RAILROAD HOLDING COMPANIES AND EVALUATION OF
PROPOSED RAIL MERGERS

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

WE APPRECIATE THE OPPORTUNITY TO BE HERE TODAY AT YOUR REQUEST TO DISCUSS THE INTERSTATE COMMERCE COMMISSION'S (ICC'S) (1) JURISDICTION OVER AND MONITORING OF RAILROAD COMPANIES, INCLUDING THE ACQUISITION OF THE BURLINGTON NORTHERN RAILROAD BY A HOLDING COMPANY, (2) ABILITY TO REVIEW MERGER APPLICATIONS DESPITE STAFF REDUCTIONS, AND (3) PREPARATION AND USE OF POST-MERGER STUDIES TO ASSESS PROPOSED MERGER APPLICATIONS.

ICC HAS LIMITED JURISDICTION OVER ACQUISITION OF CARRIERS BY HOLDING COMPANIES

UNDER THE INTERSTATE COMMERCE ACT, ICC DOES NOT HAVE JURISDICTION OVER THE ACQUISITION OF A SINGLE RAIL CARRIER BY A NON-CARRIER, SUCH AS A HOLDING COMPANY. ICC'S JURISDICTION APPLIES ONLY WHEN A HOLDING COMPANY IS ACQUIRING CONTROL OF AT LEAST TWO CARRIERS, OR WHERE A HOLDING COMPANY ALREADY CONTROLS ONE CARRIER AND SEEKS TO ACQUIRE ANOTHER. ICC HAS RULED THAT A RAIL SYSTEM COMPRISED OF A NUMBER OF RAIL CARRIERS BUT OPERATED AND MANAGED AS A SINGLE SYSTEM WOULD BE CONSIDERED A SINGLE CARRIER--CALLED THE "SINGLE SYSTEM DOCTRINE." ICC'S RATIONALE FOR EXCLUDING SUCH SYSTEMS FROM ITS JURISDICTION IS THAT THE NON-CARRIER ACQUIRING CONTROL OF AN EXISTING, SINGLE INTEGRATED CARRIER SYSTEM INVOLVES ONLY A CHANGE IN STOCK OWNERSHIP AND THE INSERTION OF A NEW CORPORATE

ENTITY AT THE TOP AND DOES NOT OTHERWISE ALTER THE OPERATIONS OF THE AFFILIATED CARRIERS.

ICC APPLIED THE SINGLE SYSTEM DOCTRINE WHEN DECIDING THAT IT DID NOT HAVE JURISDICTION OVER BURLINGTON NORTHERN, INC.'S CREATION OF A HOLDING COMPANY IN 1981. THE HOLDING COMPANY WAS FORMED TO OWN BOTH ITS TRANSPORTATION AND NON-TRANSPORTATION COMPANIES AND ASSETS. THIS WAS TO PROVIDE GREATER FLEXIBILITY IN FINANCING NON-TRANSPORTATION BUSINESS ACTIVITIES INVOLVING THE ISSUANCE OF SECURITIES TO DEVELOP NATURAL RESOURCES OWNED BY THE RAILROAD AND ITS SUBSIDIARIES. ACCORDING TO AN ICC STUDY, THIS IS A COMMON REASON FOR FORMING HOLDING COMPANIES.

ICC WAS REQUESTED TO EXERT ITS JURISDICTION OVER THE PROPOSED FORMATION OF THE BURLINGTON NORTHERN HOLDING COMPANY ON THE BASIS THAT IT INVOLVED THE ACQUISITION OF AT LEAST TWO CARRIERS. IN ITS JUNE 5, 1981, DECISION, ICC DENIED THE PETITIONS STATING THAT BURLINGTON NORTHERN, INC.'S, FORMATION OF A HOLDING COMPANY FITS WITHIN THE SINGLE SYSTEM DOCTRINE. ICC SAID THAT BURLINGTON NORTHERN, INC., OPERATES ALL OF ITS COMPANIES--BOTH RAIL AND NON-RAIL TRANSPORTATION SUBSIDIARIES--AS AN INTEGRATED TRANSPORTATION SYSTEM UNDER ITS DIRECT CONTROL AND MANAGEMENT. ICC CITED SPECIFIC EXAMPLES THAT SHOWED BURLINGTON NORTHERN OPERATES AS A SINGLE SYSTEM.

ICC'S DECISION WAS APPEALED. IN FEBRUARY 1982, THE U. S. COURT OF APPEALS FOR THE EIGHTH CIRCUIT UPHELD THE SINGLE SYSTEM DOCTRINE, STATING: "ALTHOUGH THIS INTERPRETATION OF THE PHRASE '2 CARRIERS' IS BY NO MEANS THE ONLY POSSIBLE ONE, NOR NECESSARILY THE CONSTRUCTION WE WOULD ADOPT IF WE WERE FREE TO DECIDE THE QUESTION INDEPENDENTLY, IT IS NOT UNREASONABLE, AND WE THEREFORE DEFER TO THE COMMISSION'S VIEW OF ITS OWN GOVERNING STATUTE, ESPECIALLY SINCE THIS CONSTRUCTION HAS BEEN CONSISTENTLY ADHERED TO OVER A LONG PERIOD OF TIME." THE COURT OF APPEALS RETURNED THE CASE TO ICC TO DETERMINE WHETHER BURLINGTON NORTHERN, INC'S, INTERESTS IN TERMINAL AND SWITCHING COMPANIES TAKE THIS CASE OUT OF THE SINGLE-SYSTEM DOCTRINE--AN ISSUE WHICH ICC DID NOT ADDRESS IN ITS DECISION.

ANOTHER TRANSACTION INVOLVING BURLINGTON NORTHERN WHICH ICC DETERMINED WAS NOT WITHIN ITS JURISDICTION AND THEREFORE DID NOT REQUIRE ITS APPROVAL WAS THE PROPOSED MERGER OF THE COLORADO

AND SOUTHERN RAILWAY COMPANY INTO THE BURLINGTON NORTHERN RAILROAD COMPANY. BEFORE THIS MERGER, BURLINGTON NORTHERN OWNED A VAST MAJORITY OF THE OUTSTANDING STOCK IN COLORADO AND SOUTHERN AND THEREBY CONTROLLED IT.

IN OCTOBER 1981, BURLINGTON NORTHERN RAILROAD NOTIFIED ICC OF THE PROPOSED MERGER WITH THE COLORADO SOUTHERN RAILWAY. THE BURLINGTON NORTHERN CITED SEVERAL REASONS FOR THE MERGER INCLUDING THE SIMPLIFICATION OF CORPORATE OPERATIONS AND CONSOLIDATION OF OUTSTANDING DEBT. ON DECEMBER 28, 1981, ICC DECIDED THE MERGER WAS EXEMPT FROM ITS JURISDICTION BECAUSE THE TRANSACTION FITS WITHIN ICC'S EXEMPTION FOR TRANSACTIONS WITHIN A CORPORATE FAMILY THAT DO NOT ADVERSELY AFFECT SERVICE, OR RESULT IN SIGNIFICANT OPERATIONAL OR COMPETITIVE BALANCE CHANGES. WE BELIEVE THE EXEMPTION IN THIS CASE IS CONSISTENT WITH THE RATIONALE UNDERLYING THE SINGLE SYSTEM DOCTRINE.

ICC'S MONITORING OF RAILROAD HOLDING COMPANIES

ICC, IN A 1977 REPORT TO THE CONGRESS, STATED THAT THE OPPORTUNITY EXISTS FOR HOLDING COMPANIES CONTROLLING RAILROADS' SYSTEMS OPERATIONS TO MAKE USE OF THE RAILROADS' INCOME, PROPERTY, AND OTHER ASSETS FOR NON-RAIL PURPOSES TO THE POSSIBLE DETRIMENT OF THE RAILROADS. METHODS THAT COULD BE USED BY THE HOLDING COMPANIES INCLUDE TRANSFER OF RAILROADS' NON-TRANSPORTATION ASSETS TO THE HOLDING COMPANY, ISSUING SECURITIES BACKED BY RAILROADS' ASSETS, ISSUING DIVIDENDS FROM RAILROADS' REVENUES, AND BORROWING MONIES FROM ITS RAILROAD SUBSIDIARIES. ICC'S REPORT INDICATED THAT RATHER THAN REQUESTING INCREASED JURISDICTION IT WOULD, WHEN CONDUCTING AUDITS OF RAIL CARRIERS' RECORDS, IDENTIFY ANY TRANSACTIONS WHICH MIGHT HAVE A SIGNIFICANT ADVERSE IMPACT UPON THE RAILROAD AND COMPEL THE COMPANIES TO REPORT TO ICC PERTINENT INFORMATION REGARDING RAILROAD-RELATED OPERATIONS.

ICC'S MONITORING ACTIVITIES APPEAR LIMITED. ICC MONITORS HOLDING COMPANY RAILROAD-RELATED TRANSACTIONS THROUGH AUDITS OF RAILROAD RECORDS AND REVIEWS OF ACCOUNTING AND SECURITY REPORTS. HOWEVER, THE AUDITS OF RAILROAD RECORDS ARE ONLY CONDUCTED EVERY 2 TO 3 YEARS. IN ADDITION, THE ACCOUNTING AND SECURITIES REPORTS REVIEWED BY ICC DO NOT PROVIDE SUFFICIENT INFORMATION TO IDENTIFY

MANY OF THE HOLDING COMPANIES' RAILROAD-RELATED TRANSACTIONS, SUCH AS WHETHER A HOLDING COMPANY ACQUIRING A LOAN USES ITS RAILROAD'S ASSETS AS SECURITY. ALTHOUGH ICC ALSO HAS ACCESS TO THE REPORT THAT HOLDING COMPANIES SUBMIT TO THE SECURITIES AND EXCHANGE COMMISSION, THE REPORT DOES NOT IDENTIFY A RAILROAD'S INVOLVEMENT IN SECURITY ISSUANCES. 1/

ICC OFFICIALS TOLD US THAT THEY DO NOT MONITOR ALL HOLDING COMPANIES' RAIL-RELATED OPERATIONS BECAUSE OF STAFF LIMITATIONS, THE REDIRECTION OF ICC POLICY TOWARD LESS REGULATION, INCLUDING A REDUCTION IN RAILROAD REPORTING REQUIREMENTS, AND THE FACT THAT NO ABUSES ADVERSELY AFFECTING A RAILROAD'S FINANCIAL STABILITY HAVE BEEN IDENTIFIED UNDER THE CURRENT MONITORING SYSTEM. ICC OFFICIALS ALSO SAID THAT EVEN IF AN ABUSE WAS IDENTIFIED THEY DO NOT BELIEVE ICC HAS THE AUTHORITY TO TERMINATE OR RESTRICT THE TRANSACTION BECAUSE THE SINGLE CARRIER HOLDING COMPANIES ARE EXEMPT FROM ICC'S JURISDICTION UNDER EXISTING LEGISLATION.

WE BELIEVE ICC NEEDS TO MONITOR ALL HOLDING COMPANIES' RAIL-RELATED OPERATIONS BECAUSE THE OPPORTUNITY FOR ABUSE DOES EXIST. ICC'S CURRENT MONITORING EFFORTS PROVIDE LIMITED ASSURANCE THAT IT IS ALERT TO ALL RAILROAD-RELATED TRANSACTIONS BY A HOLDING COMPANY THAT COULD ADVERSELY AFFECT A RAILROAD. ICC NEEDS TO MONITOR SUCH TRANSACTIONS SO THAT POSSIBLE ABUSES ARE IDENTIFIED IN SUFFICIENT TIME TO TAKE APPROPRIATE ACTION, INCLUDING ASKING THE CONGRESS TO INCREASE ITS AUTHORITY.

STAFF REDUCTIONS AND THEIR IMPACT ON ICC'S MERGER REVIEWS

ICC'S OVERALL STAFF HAS DECREASED BY ABOUT 512 OR ABOUT 25 PERCENT SINCE FISCAL YEAR 1979. THE OFFICE OF TRANSPORTATION ANALYSIS--THE OFFICE RESPONSIBLE FOR ASSISTING ICC ON ITS MERGER ANALYSES AND FOR CONDUCTING POSTMERGER ANALYSES--STAFF YEAR CEILING HAS BEEN REDUCED FROM 92 TO 52 SINCE 1979. THE UNIT WITHIN THE OFFICE RESPONSIBLE FOR ASSISTING IN ICC'S MERGER REVIEWS--THE SECTION OF RESEARCH AND ANALYSIS--CURRENTLY HAS A PROFESSIONAL STAFF OF 14. DESPITE STAFF REDUCTIONS, ICC OFFICIALS BELIEVE THAT SUFFICIENT STAFF EXISTS TO ADEQUATELY REVIEW PROPOSED MERGERS BECAUSE:

1/THE SECURITIES AND EXCHANGE COMMISSION REVIEWS THE REPORT TO ASSURE THE HOLDING COMPANIES' FINANCIAL STATUS IS ACCURATELY PORTRAYED.

--A NUMBER OF ICC'S OFFICES ASSIST IN ANALYZING VARIOUS ASPECTS OF A MERGER. FOR A LARGE MERGER, A TEAM CONSISTING OF REPRESENTATIVES FROM ICC'S OFFICE OF PROCEEDINGS, OFFICE OF HEARINGS, BUREAU OF ACCOUNTS, OFFICE OF COMPLIANCE AND CONSUMER ASSISTANCE, AND OFFICE OF TRANSPORTATION ANALYSIS MAY BE ASSEMBLED. TEAM MEMBERS WORK FULL OR PART TIME ON A MERGER CASE. SINCE NOT ALL MERGERS REQUIRE HIS OFFICE'S INPUT AND THE STAGGERS RAIL ACT REDUCED THE SCOPE OF SOME MERGER REVIEWS, THE DIRECTOR BELIEVES THAT NECESSARY STAFF IS AVAILABLE TO DO SUCH ANALYSES.

--A NUMBER OF THE OFFICE'S DUTIES HAVE BEEN REDUCED OR ELIMINATED. AFTER THE MOTOR CARRIER ACT AND THE STAGGERS RAIL ACT WERE PASSED, WHICH CHANGED THE REGULATIONS IN BOTH THE MOTOR AND RAIL SECTORS, ICC DECIDED IN FISCAL YEAR 1982, TO CHANGE THE OFFICE'S PRIMARY MISSION TO PROVIDING ECONOMIC ANALYSES AND ANALYTICAL SUPPORT FOR ICC'S ACTIVITIES. THE OFFICE HAS RETAINED A PRIMARY FUNCTION OF ASSISTING MERGER ANALYSIS TEAMS AND PROVIDING STAFF SUPPORT FOR REVIEWS OF MERGER APPLICATIONS.

--THE NUMBER OF MAJOR MERGER CASES WHICH REQUIRE A FULL REVIEW IS LIMITED AND WITH RECENT LEGISLATION IS REDUCED EVEN FURTHER. THUS, FEWER STAFF ARE NECESSARY, ON A FULL TIME BASIS, TO ASSIST ON MERGER REVIEWS. SINCE 1979, ICC HAS ONLY RECEIVED SIX MAJOR MERGER PROPOSALS--THREE OF WHICH HAVE YET TO BE DECIDED. EACH OF THESE MERGERS VARIES IN SIZE, COMPLEXITY, AND PUBLIC REACTION AND PARTICIPATION. AS A RESULT, THE STAFF REQUIRED AND THE LENGTH OF TIME THEY ARE REQUIRED, VARIES FROM MERGER TO MERGER. RATHER THAN COMPROMISE THE QUALITY OF ITS WORK, THE DIRECTOR SAID THAT ICC WOULD CONTRACT FOR SPECIFIC STUDIES IF ICC BECOMES UNEXPECTEDLY FLOODED WITH MERGER PROPOSALS.

ICC NOW BELIEVES THE USEFULNESS OF POSTMERGER STUDIES IS LIMITED

DURING JUNE 1979 SENATE HEARINGS BEFORE THE SUBCOMMITTEE ON ANTITRUST, MONOPOLY, AND BUSINESS RIGHTS, SENATE COMMITTEE ON THE JUDICIARY, FORMER ICC CHAIRMAN O'NEAL TESTIFIED THAT ICC WAS RESPONSIBLE FOR ANALYZING POSTMERGER DATA AND THAT ICC WAS IN THE PROCESS OF CONTRACTING FOR SUCH A STUDY WITH PRINCETON UNIVERSITY.

IN RESPONSE TO SENATOR BAUCUS' REQUEST, WE INQUIRED IN NOVEMBER 1981 WHETHER THE STUDY REFERRED TO BY THE CHAIRMAN HAD BEEN DONE. ICC INFORMED US THE STUDY HAD NOT BEEN PERFORMED AND WE RELAYED THIS INFORMATION TO THE SENATOR BY LETTER DATED DECEMBER 2, 1981. SUBSEQUENTLY ICC SAID THAT IN SPITE OF ITS EARLIER STATEMENTS TO US, IT HAD FOUND THE STUDY, WHICH IT THEN MADE AVAILABLE. ICC OFFICIALS SAID THEY COULD NOT FIND THE STUDY WHEN WE INITIALLY ASKED BECAUSE THE STUDY PROPOSED BY FORMER CHAIRMAN O'NEAL WAS TO BE BROAD-BASED AND THE STUDY ACTUALLY DONE WAS SUBSTANTIALLY LIMITED IN SCOPE. IN ADDITION, THE STAFF INVOLVED WITH THE STUDY WAS NO LONGER WITH ICC. HOWEVER, AFTER CONFERRING WITH THE FORMER ICC DIRECTOR RESPONSIBLE FOR THE STUDY, ICC OFFICIALS DETERMINED THAT THE NARROWLY SCOPED STUDY WAS THE ONE MENTIONED BY THE FORMER CHAIRMAN.

THE STUDY WAS ISSUED IN THE SPRING OF 1980. HOWEVER, IT DID NOT ACCOMPLISH ICC'S ORIGINAL GOALS OF DETERMINING WHETHER THE BENEFITS OF THE MERGERS REVIEWED WERE REALIZED NOR DID IT PROVIDE INFORMATION THAT COULD BE PROJECTED TO OTHER MERGERS. ACCORDING TO THE OFFICIAL RESPONSIBLE FOR THE STUDY, THE SCOPE WAS REDUCED BECAUSE OF DATA LIMITATIONS. THE STUDY DEVELOPED ONLY EXPECTED RANGES OF TRAFFIC DIVERSION FROM ONE RAILROAD TO THE MERGED RAILROADS. ICC TOLD US IT DID NOT CONVEY THE STUDY'S RESULTS TO THE SUBCOMMITTEE BECAUSE THE FINDINGS WERE LIMITED AND INCONCLUSIVE.

ICC OFFICIALS ACKNOWLEDGED THAT PROPERLY CONDUCTED POSTMERGER STUDIES MAY PROVIDE USEFUL INFORMATION FOR DEVELOPING ITS MERGER POLICIES, BUT QUESTION (1) WHETHER MERGERS ARE SUFFICIENTLY SIMILAR TO USE THE RESULTS OF ONE MERGER TO ASSESS THE POTENTIAL IMPACT OF A PROPOSED MERGER, AND (2) IF DATA ANALYSIS CAN PRODUCE CONCLUSIVE FINDINGS.

ATTORNEYS IN ICC'S OFFICE OF PROCEEDINGS STATED THAT POSTMERGER STUDIES COULD BE SUBMITTED AS EVIDENCE DURING CURRENT MERGER PROCEEDINGS. SINCE EACH MERGER IS DIFFERENT, HOWEVER, EVIDENCE FROM POSTMERGER STUDIES COULD EASILY BE CHALLENGED ON THE GROUNDS THAT THE MERGERS WERE NOT SUFFICIENTLY SIMILAR FOR COMPARISON. THUS, THE FACT THAT OTHER MERGERS DID NOT ACHIEVE THEIR ANTICIPATED BENEFITS WOULD NOT PROVIDE ASSURANCE THAT THE MERGER BEING PROPOSED WOULD NOT ACHIEVE ITS ANTICIPATED BENEFITS.

THESE STUDIES COULD ASSIST ICC'S REVIEWS OF PROPOSED MERGERS, EITHER BY DEVELOPING METHODS FOR DATA ANALYSIS, OR BY HIGHLIGHTING POLICY ISSUES. HOWEVER, DOING STUDIES MUST BE WEIGHED AGAINST THEIR COST AND THE POSSIBILITY THAT POSTMERGER STUDIES MAY NOT PRODUCE USEABLE RESULTS.

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MR. CHAIRMAN, THIS CONCLUDES MY PREPARED STATEMENT. WE ARE PREPARED TO ANSWER ANY QUESTIONS YOU MAY HAVE AT THIS TIME.

Mr. TAYLOR. Mr. Chairman, let me start out by saying that I have with me this morning Mr. Louis Gitomer, who is our Acting Deputy Director of the Section of Finance, Office of Proceedings, on my left. On my right is Janice Rosenak, who is the Commission's Legislative Counsel. Sitting behind me are Mr. William F. Moss, who is Deputy Director of the Commission's Bureau of Accounts, in the event there are some questions in his area; also, J. Warren McFarland, who is our Director of the Office of Compliance and Consumer Assistance; together with William R. Southard, who is the Director of the Commission's Office of Transportation Analysis.

We appreciate this opportunity to testify before you today to share with you the Interstate Commerce Commission's policies regarding railroad mergers and to discuss our activities in this area. Let me begin by saying that the Commission shares your concerns regarding the effects of rail restructuring on the financial viability of our Nation's rail system and the maintenance of essential rail services to the shipping public.

Today I will be discussing the Commission's policies and procedures in the rail merger area, the status of pending merger applications, and the Commission's views regarding the holding company corporate structure which has now been adopted by most of the Nation's railroads.

I would like to begin my testimony by discussing the Commission's policy and procedures related to major mergers, those involving at least two class I railroads.

The Commission's consideration of any major merger application is governed by the criteria prescribed in our enabling statute as well as the rail transportation policy.

In order to determine whether a transaction is in the public interest, the Commission performs a balancing test; that is, weighing the potential benefits of the proposed consolidation against any potential harm which might result therefrom. Benefits which can result from rail consolidation include the creation of a more financially sound competitor, a reduction in redundant facilities or increased marketing opportunities.

There are two potential results from consolidations which would harm the public and which the Commission must carefully consider in any merger case. They are reduction of competition and harm to essential services, the latter consideration being particularly important.

The Commission has recently revised its procedures governing railroad consolidations. In a decision dated February 19, 1982, in ex parte No. 282, sub-No. 3, Railroad Consolidation Procedures, we revised the informational requirements for rail carriers seeking authority to consolidate. We also incorporated the new time limits for consideration of merger applications contained in the Staggers Rail Act of 1980, as well as other changes necessitated by that legislation.

The Commission recognizes the problems that can be caused by undue delay in the consideration of rail merger applications. Therefore, we are committed to an expedited timetable for such consideration. Our commitment to expeditious yet thorough analysis of merger applications is demonstrated by the fact that we anticipate that final decisions will be rendered in all of the currently pending merger applications well before the statutory deadlines mandated by the Staggers Act.

Although the Commission has experienced staff reductions as a result of budgetary constraints, we do not believe this will affect our ability to review merger applications.

The Commission has been considering four major rail merger proposals. I would like to provide the committee with a brief status report of these proceedings.

In December of 1980, the Norfolk Southern Corp., a noncarrier holding company, filed an application for control of the Norfolk & Western Railway Co., and the Southern Railway Co. Yesterday, the Commission issued a final decision approving the merger, approximately 15 months before the original statutory deadline.

Union Pacific Corp. is a noncarrier holding company which controls the Union Pacific Railroad Co., among other interests. The Union Pacific Co. has filed applications to bring the Missouri Pacific Railroad Co. and the Western Pacific Railroad Co. under its control. This proposal has generated considerable controversy and has resulted in several extensive requests for trackage rights by competing railroads as a condition of the merger. The Commission is required to issue a final decision no later than April 15, 1983. Once again, we are hoping to issue our decision before the statutory deadline.

The last two mergers before the Commission relate to the efforts of Guilford Transportation Industries, Inc., (GTI), a noncarrier holding company, to put together a regional rail system in the Northeast. GTI presently controls the Maine Central Railroad Co. GTI has filed an application for approval to control the Boston and Maine. The Commission must issue a final decision on the application by April 26, 1982.

GTI's application for approval to control the Delaware and Hudson Railway Co. is contingent upon approval of GTI's acquisition of the Boston & Maine Corp. A final decision in this case is due by July 28, 1982. Oral hearing in this proceeding began on March 22, 1982.

As a general rule, the Commission has not conducted comprehensive, ex post evaluations of rail mergers. In the studies which we have conducted, the Commission has encountered a number of difficulties with postmerger analysis, because there are so many nonmerger related variables which can affect a carrier's performance.

For example, the state of the economy, availability of capital, and changes in Government policy and regulation can all affect projections made by carriers during merger proceedings.

In addition, benefits from railroad mergers may not become evident for some time. Therefore, a considerable period must elapse after consummation of a merger before a final conclusion can be reached regarding the impacts of the merger. Obviously, this delay reduces the usefulness of any postmerger study.

In addition, the findings and conclusions in a postmerger analysis cannot realistically be utilized for future Commission action since the facts in each case differ so greatly. Therefore, it appears that the cost of comprehensive postmerger analyses in terms of our resources may far outweigh any benefits. However, the Commission's Bureau of Accounts does examine the subsequent performance of merged carriers as a part of the general oversight of the financial condition of the railroad industry.

An issue that I know is of great concern to members of this committee and particularly to you, Senator, is the formation of holding companies in the railroad industry and the potentially harmful effects this could have on rail service to the shipping public. As you may recall, section 903 of the Railroad Revitalization and Regulatory Reform Act of 1976 directed the Commission to conduct a study to determine the effects, if any, that the diverse railroad corporate structures have on effective transportation, intermodal competition, revenue levels, and any other pertinent aspects of national transportation. The results of this investigation were submitted to Congress in 1977 in a report entitled, "Railroad Conglomerates and Other Corporate Structures." In general, the report stated that the conglomerate structure has in the past and continues to have the potential of separating assets from railroad subsidiaries.

The report expressed concern that railroad noncarrier resources and income had been divorced from the railroads in many cases without adequate compensation. On the whole, the study did not find any substantial benefits to the carrier subsidiaries in terms of improved profitability, maintenance, or modernization of the railroads which resulted directly from the formation of holding companies.

I should mention at this point that the railroad conglomerate report has not been adopted by the present Commission.

Since issuance of the report to Congress in 1977, the Commission has not initiated any major investigation into holding companies and their effect on their rail carrier subsidiaries, but our auditors do routinely investigate transactions between carriers and their affiliated companies during regular audits of railroads. The Commission's Bureau of Accounts will be monitoring such activity more closely, I can assure you, and the Bureau will inform us periodically of its findings.

Since most holding companies have been designated by the Commission as noncarriers, the Commission does not have the authority to prescribe reporting requirements. However, the Commission does have the authority to initiate an investigation of holding companies relating to their management of rail carriers under their control. This authority includes permission to obtain information from such holding companies that the Commission deems necessary to carry out the investigation.

Although the Commission's power of inquiry under these provisions is broad, the statute only gives us the power to inquire into and report. The Commission does not have the authority to take any substantive regulatory actions, should such an investigation reveal abuses.

I might add that draft legislation has been submitted in the past which would give the ICC greater authority in this area, but no congressional action was taken. I believe the last time that was done was in 1975.

Because of the committee's particular interest in the Burlington Northern Railroad, I would like to conclude my testimony by providing a short summary of the Commission's consideration of the BN's corporate restructuring which resulted in the formation of a holding company. As you know, early in 1981, BN's board of directors announced its intention to form a holding company in order to attain greater flexibility in the development of its nontransportation assets. The Commission received three petitions requesting that we exert jurisdiction over this transaction; these petitions were denied in a decision dated June 5, 1981.

Under section 11343 of title 49, United States Code, the Commission has jurisdiction over an acquisition of control by a person that is not a carrier only if control is sought over at least two carriers. I think that has already been pointed out. Although the Burlington Northern controls a number of carriers, all of the carrier operations are conducted as part of a single integrated system under the direct control and management of the Burlington Northern.

For over 25 years, the Commission has held that it does not have jurisdiction over a noncarrier's acquisition of control of a single integrated rail system even if the system is comprised of separate corporations. The single system doctrine was applied to the *Burlington Northern* case and the petitions were denied.

On February 17, 1982, the U.S. Court of Appeals for the Eighth Circuit held that the Commission's reliance on the single system doctrine was not unreasonable. Although the decision stated that this interpretation is not the only possible one, the court deferred to the Commission's view of its own governing statute, especially since this construction has been consistently adhered to over a long period of time. However, the court remanded the case to the Commission for further findings on the issue of the Burlington Northern's interest in several terminal companies.

The matter is presently under review by the Commission. I expect a decision soon regarding the action to be taken following remand.

That concludes our summary statement. I would be glad to try and respond to any questions that you might have.

Senator BAUCUS. Thank you, Mr. Taylor. I appreciate your testimony very much.

Without objection, your entire prepared statement will be inserted.

[Material referred to follows:]

STATEMENT OF REESE H. TAYLOR, JR. CHAIRMAN, INTERSTATE COMMERCE COMMISSION BEFORE THE SENATE COMMITTEE ON THE JUDICIARY ON RAIL MERGER POLICY

March 26, 1982

Mr. Chairman and Members of the Committee:

I appreciate this opportunity to testify before you today to share with you the Interstate Commerce Commission's policies regarding railroad mergers and to discuss our activities in this area. Let me begin by saying that the Commission shares your concerns regarding the effects of rail restructuring on the financial viability of our nation's rail system and the maintenance of essential rail services to the shipping public. Today, I will be discussing the Commission's policies and procedures in the rail merger area, the status of pending merger applications, and the Commission's views regarding the holding company corporate structure which has now been adopted by most of the Nation's railroads.

MERGER POLICY AND PROCEDURES

I would like to begin my testimony by outlining in general terms the Commission's policy in the area of railroad mergers. The following discussion relates to the policy and procedures applied to major mergers -- those involving at least two class I railroads.

The Interstate Commerce Commission encourages private industry initiative that leads to the rationalization of the Nation's rail facilities and reduction of its excess capacity. One means of accomplishing these ends is rail consolidation. However, the Commission does not favor consolidations through the exercise of managerial and financial control if the controlling entity does not assume full responsibility for carrying out the controlled carrier's common carrier obligation to provide adequate service upon reasonable demand. Furthermore, the Commission does not favor consolidations that substantially reduce the transportation alternatives available to shippers unless there are substantial and demonstrable benefits to the transaction that cannot be achieved in a less anticompetitive fashion. Our analysis of the competitive impacts of a consolidation is especially critical in light of the congressionally mandated commitment to give railroads greater freedom to price without regulatory interference.

The Commission's consideration of any major merger application is governed by the criteria prescribed in our enabling statute, as well as the rail transportation policy. The criteria which must be considered in examining a proposed transaction are:

(1) the effect of the proposed transaction on the adequacy of transportation to the public;

(2) the effect on the public interest of including, or failing to include, other rail carriers in the area involved in the proposed transaction;

(3) the total fixed charges that result from the proposed transaction;

(4) the interest of carrier employees affected by the proposed transaction; and

(5) whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region.

In order to determine whether a transaction is in the public interest, the Commission must perform a balancing test -- weighing the potential benefits to the applicants and the public against the potential harm to the public. This balancing test is applied on a case-by-case basis. In the process of reaching a final decision, the Commission considers whether the benefits which the applicants hope to achieve could be realized by some means other than the proposed consolidation that would result in less potential harm to the public.

There are many benefits which can result from rail consolidation. If the resulting carrier is a financially sound competitor better able to provide adequate service, then both the carrier and the public can benefit from the transaction. Since consolidations can lead to a reduction in redundant facilities and thereby to an increase in traffic density on underused lines, operating efficiencies may be realized. Consolidations can also lead to increased marketing opportunities.

There are two potential results from consolidations which would harm the public and which the Commission must carefully consider in any merger case -- reduction of competition and harm to essential services. If two carriers serving the same market consolidate, the result would be the elimination of the competition between the two. Even if the consolidating carriers do not serve the same market, there may be a lessening of potential competition in other markets. While the reduction in the number of competitors serving a market is not in itself harmful, a reduction of competition resulting from the elimination of a competitor may be contrary to the public interest. In its consideration of merger applications, the Commission considers competition from other modes of transportation as well as competition among rail carriers.

In assessing the probable impact of a rail merger, the Commission is also concerned with the preservation of essential services. A service is essential if there is a sufficient public need for the service and adequate alternative transportation is not available. If it is shown that essential services will be adversely affected by a consolidation, the Commission may impose conditions on the transaction. Normally, the Commission will impose conditions on a consolidation only if the condition is designed to enable shippers to receive adequate service, would not pose unreasonable operating or other problems for the consolidated carrier, and would not frustrate the ability of the consolidated carrier to obtain the anticipated benefits. The Commission will consider requiring inclusion of another carrier as a condition to approval only where there is no reasonable alternative for providing essential service. In making such a decision, the Commission must determine that the facilities of the carrier to be included fit operationally into the new system, and that inclusion can be accomplished without endangering the operational or financial success of the new company.

The Commission has recently revised its procedures governing railroad consolidations. Based on the record in a rulemaking proceeding instituted on our own motion, we adopted final rules in this area by a decision dated February 19, 1982 in Ex Parte No. 282 (Sub-No. 3), Railroad Consolidation Procedures. In that decision, we revised the informational requirements for rail carriers seeking authority to consolidate. We also incorporated the new time limits for consideration of merger applications contained in the Staggers Rail Act of 1980, as well as other changes necessitated by that legislation. These revisions will result in better use of both Commission and carrier resources by reducing required information and avoiding lengthy and costly proceedings when unwarranted by their impact.

The Commission recognizes the problems that can be caused by undue delay in the consideration of rail merger applications. Therefore, we are committed to an expedited timetable for such consideration. Our commitment to expeditious yet thorough analysis of merger applications is demonstrated by the fact that we anticipate that final decisions will be rendered in all of the currently pending merger applications well before the statutory deadlines mandated by the Staggers Act. The timetable for our consideration of major merger applications is outlined below:

3-6 months prior to filing of the application -- the applicant files a prefiling notice with the Commission briefly describing the transaction.

Within 30 days of receipt of the prefiling notice -- the Commission publishes a notice in the Federal Register briefly describing the transaction and listing any additional information which must be filed with the application.

No later than 30 days after the application is filed -- the Commission accepts or rejects the application.

45 days after the application's acceptance -- written comments are filed. The Secretary of Transportation and the U.S. Attorney General must file their comments within 60 days of the date of acceptance of the application.

24 months after an application is accepted -- the evidentiary proceeding (either oral public hearing, hearing by written submissions, or another kind of evidentiary proceeding) is completed.

180 days after conclusion of the evidentiary proceeding -- the final decision is issued.

Although the Commission has experienced staff reductions as a result of budgetary constraints, we do not believe this will affect our ability to review merger applications. The Office of Transportation Analysis, which has largely been responsible for assisting the Commission in merger analyses, has in the past allotted approximately 4 to 5 staff years on merger cases, depending on the number of applications filed at any particular time. Currently, that office has 4 staff members working full-time on rail merger proposals. In addition, for major mergers, teams are ordinarily assembled to analyze the prospective merger. Typically, such a team would include representatives from the Office of Proceedings, the Office of Hearings, the Bureau of Accounts, and the Office of Compliance and Consumer Assistance, as well as the Office of Transportation Analysis. Thus, unless there is a significant increase in the number of merger applications filed, present staffing levels should be sufficient to provide adequate analyses of these applications.

PENDING RAIL MERGERS

The Commission currently has four major rail merger proposals pending consideration. I would like to provide the Committee with a brief status report on these proceedings. If more detailed information is desired with regard to any of these proceedings, we will, of course, supply such information.

In December 1980, the Norfolk Southern Corporation, a non-carrier holding company, filed an application for control of the Norfolk and Western Railway Company and the Southern Railway Company. The evidentiary record in this proceeding was closed on October 31, 1981, and yesterday, on March 25, 1982, well before the statutory deadline of April 28, 1982, the Commission issued a final decision in the Norfolk Southern matter.

Union Pacific Corporation (UPC) is a non-carrier holding company which controls the Union Pacific Railroad Company, among other interests. The UPC filed applications to bring the Missouri Pacific Railroad Company and the Western Pacific Railroad Company under its control on September 15, 1980. This proposal has generated considerable controversy and has resulted in several extensive requests for trackage rights by competing railroads as a condition of the merger. Reply briefs are due April 23, 1982. The Commission is required to issue a final decision 6 months after the evidentiary record is closed, but in no event later than April 15, 1983.

The last two mergers before the Commission relate to the efforts of Guilford Transportation Industries, Inc. (GTI), a non-carrier holding company, to put together a regional rail system in the Northeast. GTI presently controls the Maine Central Railroad Company. In October of 1981, GTI filed an application for approval to control the Boston and Maine Corporation. This proceeding is subject to the expedited time limits imposed by section 1164 of the Northeast Rail Service Act of 1981, which requires the Commission to issue a final decision by April 26, 1982.

GTI's application for approval to control the Delaware and Hudson Railway Company was filed on January 29, 1982. The application is contingent upon approval of GTI's acquisition of the Boston and Maine Corporation. In accordance with the expedited time limits of the Northeast Rail Service Act of 1981, the Commission must issue a final decision by July 28, 1982. Oral hearing in this proceeding began on March 22, 1982.

POST-MERGER STUDIES

As a general rule, the Commission has not conducted comprehensive, ex post evaluations of rail mergers. However, the Commission has, in some instances, conducted or evaluated post-merger studies. Beginning with the Penn Central merger, the Commission imposed requirements for post-merger reporting on progress and status. These study conditions were designed to enable us to examine the performance of the merged carrier to determine if the projected benefits of the merger were realized and potentially harmful effects avoided. However, the reports prepared by the carriers were largely self-serving and did not provide the type of analysis necessary to evaluate the effects of the merger.

The Commission has encountered a number of difficulties with post-merger analysis, because there are so many non-merger related variables which can affect a carrier's performance. For example, the state of the economy, availability of capital, and changes in government policy and regulation can all affect projections made by carriers during merger proceedings. Carriers should not be held accountable for failures in performance beyond their control. Among carriers in the transportation industry, railroads are perhaps the most susceptible to the vagaries of the general economy. As a result, rail traffic flows vary considerably from factors other than merger-related diversions.

In addition, benefits from railroad mergers may not become evident for some time. Therefore, a considerable period must elapse after consummation of a merger before a final conclusion can be reached regarding the impacts of the merger. Obviously, this delay reduces the usefulness of any post-merger study.

Another factor affecting the impact of post-merger analysis is the fact that findings and conclusions cannot realistically be utilized for further Commission action. Once a merger is consummated, it is all but impossible to reverse it. Moreover, information from one merger is of dubious value in evaluating later mergers, since the facts in each case differ so greatly. Therefore, it appears that the cost of comprehensive post-merger analyses, in terms of our resources, may far outweigh any benefits. However, the Commission's Bureau of Accounts does examine the subsequent performance of merged carriers as a part of the general oversight of the financial condition of the railroad industry.

HOLDING COMPANIES

An issue that I know is of great concern to members of this Committee is the formation of holding companies in the railroad industry and the potentially harmful effects this could have on rail service to the shipping public. As you may recall, Section 903 of the Railroad Revitalization and Regulatory Reform Act of 1976 directed the Commission to conduct a study to determine the effects, if any, that the diverse railroad corporate structures have on effective transportation, intermodal competition, revenue levels, and any other pertinent aspects of national transportation. In order to gather data for this study, the Commission instituted an investigation.[1] The results of this investigation were submitted to Congress in 1977 in a report entitled, "Railroad Conglomerates and Other Corporate Structures". Let me briefly summarize the conclusions reached in that report.

The 1960's witnessed a rapid upsurge in conglomerate unification of business enterprises. It was during that same period that many railroads formed holding companies. By the time of the study, nearly all of the land grant railroads, primarily located in the West, had formed or had been acquired by parent holding companies. Roughly half of the total U.S. railroad assets and operating revenues were accounted for by railroad-owned holding companies. The report noted that advantages which were cited by the holding companies as accruing to their subsidiary railroads had not yet become fully apparent. For example, there was little evidence of lower interest costs, and the carriers did not appear to be fully compensated for the tax benefits they generated for the holding company.

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[1] Ex Parte No. 323, Investigation Into the Management, Business Interrelationships and Transactions of the Below-Named Railroads, Their Controlling Holding Companies and Affiliated Companies.

The report stated that the conglomerate structure has in the past, and continues to have, the potential of separating assets from railroad subsidiaries. Rather than pursuing acquisitions, most railroad-formed holding companies depend on the development of former railroad assets for purposes of expansion and growth. The report expressed concern that railroad non-carrier resources and income had been divorced from the railroads in many cases without adequate compensation.

The interests of conglomerate management and their stockholders may not be always consistent with the public interest in a sound transportation system. If the earnings of the railroad are not sufficient to satisfy the holding company management's perceived obligations to its stockholders, then it is likely that as little money as possible would be spent on the railroad. Contrary to the suggestions of some of the holding companies who participated, on the whole the study did not find any substantial benefits to the carrier subsidiaries in terms of improved profitability, maintenance, or modernization of the railroads which resulted directly from the formation of holding companies.

Another potentially harmful effect of the holding company structure discussed in the report is the fact that it eliminates capital stock financing by railroads. As independent financing units, railroads under the control of diversified holding companies are now limited to the use of internal funds and debt financing to satisfy operating and capital improvement requirements. While some holding companies stressed their ability to assist railroads with their capital needs, the report found little evidence of such aid.

The study concluded that there was no apparent causal relationship between railroad corporate structures and the provision of effective transportation service. However, the report did express concern that continued asset separation poses a potential threat to the future health of the nation's rail system.

I should mention at this point that the Railroad Conglomerate Report has not been adopted by the present Commission.

Since issuance of the Report to Congress in 1977, the Commission has not initiated any major investigation into holding companies and their effect on their rail carrier subsidiaries, but our auditors routinely investigate transactions between carriers and their affiliated companies during regular audits of railroads. The Commission's Bureau of Accounts will be monitoring the situation closely and informing us periodically of its findings. Among the abuses we will be looking for in order to evaluate the present and potential effect on the carrier's financial status are: dissipation of carrier working capital through payment of excessive dividends to the holding company; use of carrier cash and credit for non-carrier purposes; deferral of carrier maintenance and curtailment of carrier capital outlays; and dissipation of carrier assets.

The Commission does not generally monitor the financial operations of holding companies which own railroads. Since most holding companies have been designated by the Commission as non-carriers, the Commission does not have the authority to prescribe reporting requirements. However, the Commission does have the authority to initiate an investigation of holding companies relating to their management of rail carriers under their control.2/ This authority includes permission to obtain information from such holding companies that the Commission deems necessary to carry out the investigation.3/

Although the Commission's power of inquiry under these provisions is broad, the statute only gives us the power to "inquire into and report". The Commission does not have the

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2/ 49 U.S.C. 10321(b)(2).

3/ 49 U.S.C. 10321(b)(3). See also, 49 U.S.C. 11144 which gives the Commission the power to "inspect and copy any record of -- a person controlling ... a carrier ..."

authority to take any substantive regulatory actions, should such an investigation reveal abuses.

Because of the Committee's particular interest in the Burlington Northern Railroad, I would like to conclude my testimony by providing a short summary of the Commission's consideration of the BN's corporate restructuring which resulted in the formation of a holding company. As you know, early in 1981, BN's Board of Directors announced its intention to form a holding company in order to attain greater flexibility in the development of its non-transportation assets. The Commission received three petitions requesting that we exert jurisdiction over this transaction; these petitions were denied in a decision dated June 5, 1981.

Under section 11343 of title 49, United States Code, the Commission has jurisdiction over "an acquisition of control ... by a person that is not a carrier" only if control is sought over "at least 2 carriers". Although BN controls a number of carriers, all of the carrier operations are conducted as part of a single integrated system, under the direct control and management of BN. For example, their capital budget and performance plans are either established or approved annually by BN. Their accounts are supervised by BN, and their financial results are consolidated with BN's for reporting purposes.

For over 25 years, the Commission has held that it does not have jurisdiction over a noncarrier's acquisition of control of a single integrated rail system, even if the system is comprised of separate corporations.[4] Since the Commission was not persuaded that this statutory construction should be modified, the single system doctrine was applied to the BN case and the petitions were denied.

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[4] Louisville & Jeffersonville Bridge and Railroad Company Merger, 290 I.C.C. 725; 295 I.C.C. 11; aff'd Alleghany Corp. et. al. v. Breswick & Co. et al., 353 U.S. 151 (1957).

On February 17, 1982, the U.S. Court of Appeals for the Eighth Circuit held that the Commission's reliance on the single system doctrine was not unreasonable.[5] Although the decision stated that this interpretation is not the only possible one, the Court deferred to the Commission's view of its own governing statute, especially since this construction has been consistently adhered to over a long period of time. However, the Court remanded the case to the Commission for further findings on the issue of BN's interest in several terminal companies. The Commission must determine if BN has control of those companies, and whether this makes the holding company transaction an "acquisition of control of at least 2 carriers by a person that is not a carrier". The matter is presently under review by the Commission, and I expect a decision soon as to the action to be taken following remand. If the Commission does not appeal, it could issue a further decision on the existing record or additional evidence could be requested. I will keep you informed with regard to further developments in the proceeding.

That concludes my prepared statement. I would be glad to respond to any questions that you might have.

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[5] Brotherhood of Railway and Airline Clerks, et al. v. Burlington Northern, Inc., No. 81-1661 (8th Cir. February 17, 1982).

Commissioner Andre did not participate.

Senator **Baucus**. Mr. Krueger, I first want to thank you for your staff. You have got a great staff. They have been very helpful in helping us prepare for this hearing. I want to personally thank you and your staff for their help.

I appreciate your testimony very much, too.

You indicated that ICC's interpretation of the single carrier and single system exclusion which Mr. Taylor just referred to has been upheld by the courts, as Mr. Taylor himself so stated. In your view, are there alternative interpretations that could be applied by the ICC without Congress having to amend the Interstate Commerce Act on this very question? Could ICC without any statutory change, in your view, come up with a different interpretation of that provision?

Mr. **Krueger**. We have not made any specific determination whether there are other reasonable alternatives although I think we would go along with what the court said, that there probably could be some alternative interpretations.

Senator **Baucus**. Do any other alternatives come to mind?

Mr. **Krueger**. I do not think we have any at this time.

Senator **Baucus**. Could the ICC have looked to see what other transportation companies are available, whether the applicant has a trucking operation and a rail operation, and so forth?

Mr. **Crystal**. I think that any change in interpreting the law at this point might require legislation because we have an interpretation that has been consistently made over a long period of time. A court might find it arbitrary at this point for the Commission to change its interpretation.

Senator **Baucus**. What you are saying is that, despite the language of the court, saying perhaps they could have come up with a different interpretation, this interpretation was not unreasonable. The further complication is the long precedence, which would be a constraint, in your view, on a different interpretation?

Mr. **Crystal**. Yes, correct.

Senator **Baucus**. Therefore, it might require some statutory change?

Mr. **Crystal**. Yes.

Senator **Baucus**. Do you have any reaction to that point, Mr. Taylor?

Chairman **Taylor**. I suppose, even though it has gone on for 25 years, the Commission could change its position on this question, assuming a majority was in favor of doing so. We are a collegial body, and we would have to do that. I could not change it all by myself. But I think I would agree with the statement made that, in view of the long past practice and the holding of the court, a legislative change might be preferable.

Senator **Baucus**. How strong is that precedential value in your view? Are there a sufficient number of different interpretations of equal validity so that that precedential value is not as important? Or, in your view, is the long string of precedents so strong that it virtually has the force of law?

Chairman **Taylor**. If you are asking me personally——

Senator **Baucus**. I am asking you personally.

Chairman **Taylor**. I think you can live in error for 25, 50, or 100 years. I have no problem whatsoever, in the consideration of new circumstances, to change your mind and take a different tack. I would not have any difficulty with it at all. But whether I, as I say, could get a majority of the Commission to agree with me on any particular change in policy at this point in time, I really do not know.

Senator **Baucus**. Mr. Krueger, you indicated that the ICC believes that its staff for reviewing rail merger proposals is adequate if the agency redeploys staff and contracts specific studies outside of the agency. Is that correct?

Mr. **Krueger**. Yes, sir.

Senator **Baucus**. You also indicated in your testimony that ICC's current monitoring of holding company activities is inadequate. I believe you stated that the ICC's current monitoring efforts provide limited assurance that it is alert to all railroad related transactions by a holding company that could adversely affect a railroad.

Do you have any specific recommendations on how they might improve their monitoring activities?

Mr. **Bloom**. Mr. Chairman, as stated in our testimony, ICC needs to monitor all holding companies' rail-related operations. The opportunity for abuse does exist. In our opinion, audits every 2 or 3 years is not frequent enough to insure abuses are identified in a timely manner.

Aiso, the financial reports do not identify all holding companies, railroad-related transactions. Therefore, ICC needs to regularly obtain information in sufficient detail to be aware of financial transactions which can adversely affect a railroad such as a transfer of carrier assets for nontransportation services, the excessive payment of carrier dividends to the holding company, and the restriction of carrier capital outlays. ICC needs to monitor such transactions so that possible abuses are identified in sufficient time to take appropriate action, including asking the Congress to increase its authority.

Senator **Baucus**. What specific recommendations would you have? Should there be more frequent audits?

Mr. **Blume**. Yes; I think the problem is that after 2 or 3 years an event could take place, such as a transfer of assets, that ICC would not be aware of. By that time, the railroad may be in financial difficulty. The holding company may be solvent but the railroad itself may have trouble in its operations.

Senator **Baucus**. What about this question of ex post studies of rail mergers? You touched on it, Mr. Krueger. Would you expand on that a little more? Are not we left with a situation where ICC accepts merger benefit assertions that are never verifiable if we do not have some kind of postmerger analysis?

Mr. **Krueger**. I think that is generally true. Mr. Blume might expand on that a little bit.

Mr. **Blume**. While we do have some concern over the ability to estimate benefits, we recognize the difficulty in initially determining the benefits as well as verifying when they are realized, or if they are ever going to be realized. According to DOT as well as ICC officials, determining postmerger benefits is difficult. For example, in one postmerger study, the staff could not verify that benefits occurred 16 years after the merger was approved. However, in our opinion, ICC should recognize the problems associated with benefit determinations and realizations when considering the initial application for a merger. In other words, recognize that when they make their decision the benefit may never be realized or it may not be an accurate estimation.

Senator **Baucus**. To what degree do you recommend postmerger analysis?

Mr. **Blume**. I think, again, you would have to go back to the cost and the benefit that could be derived. I think in using it for policy analysis, doing some studies might be helpful in setting precedent for future policy decisions. But, actually, on an individual-by-individual merger, it might be very, very difficult, as exemplified by studies that had been done previously: the one by Princeton that we referred to in our statement, and the one done by DOT—I think it was the Federal Railway Administration. It just is very difficult, Mr. Chairman, to get the benefits developed.

Mr. **Krueger**. I think out of those types of studies some general thoughts can be garnered and used in evaluating future merger proposals such as whether a particular benefit could be achieved.

Senator **Baucus**. Mr. Taylor, if the Burlington Northern had disclosed its intention to form a holding company prior to the consummation of its merger with the Frisco, might the Commission have been obligated to or entitled to exercise its jurisdiction and review that proposal?

Chairman **Taylor**. I think they might have. My problem with that question, however, Senator, is that I was not around when that was done. That is kind of a difficult one to answer on a hypothetical basis. I really do not know what personally I might have done. But I think your scenario is conceivable, yes.

Senator **Baucus**. Do you have any personal views on what you would have done? I am assuming you could control the Commission.

Chairman **Taylor**. That is also a good question, too. I have been sitting there since July with four commissioners trying very hard to get a majority on many, many matters. So, I am very aware of the majority problem.

Senator **Baucus**. We have the same problem up here.

Chairman **Taylor**. I certainly would have given it serious consideration. I will certainly go along with that.

Senator **Baucus**. So, you think that, had BN disclosed its intention to form a holding company prior to the consummation, in those circumstances there is a strong possibility anyway that the Commission would have exercised its jurisdiction?

Chairman **Taylor**. I would have been concerned about it. That I can assure you. Now, just exactly what we would have done as a result, given that particular set of circumstances, I am really not sure. But I certainly would have given it serious consideration.

Senator **Baucus**. Does it concern you that the railroad operated in the opposite way; that is, consummated the merger first and then filed an application to form a holding company? Does that concern you?

Chairman **Taylor**. We are going to be followed, I guess, by Mr. Bressler. I am sure he is in a far better position to comment on this than I am. Of course, I was not even on the Commission at the time. It is my understanding that the prior management felt that there were some reasons which had nothing to do with anything else they were doing, that indicated that they could not form the holding company. They were concerned about securities regulation and so on. They apparently deferred the decision. Whether in fact that is true and what the basis for it is and what the old management's view was vis-a-vis the new management, I am sure Mr. Bressler would be in a much better position to answer than I am.

I think there were some apparent considerations involved that the present management took into account and then decided. I do not think anybody sat down to plan the sequence of events, although——

Senator BAUCUS. Not from BN's point of view but from the Commission's point of view, do you think the BN would have anything to fear from the Commission with a public review by the Commission of the holding company application?

Chairman TAYLOR. That the BN would have anything to fear?

Senator BAUCUS. Yes.

Chairman TAYLOR. Well, I do not know whether they would or not. I do not see why they should have a problem with it, frankly. But I suppose that anyone who is regulated doesn't want us to, assert our jurisdiction any more than we have to. So, perhaps they would have some fears about our just taking a look at all. But I do not see why they should really have any reason to be fearful.

Senator BAUCUS. The BN stated in its holding company securities prospectus that it formed the holding company in part to avoid ICC review of its securities issuance. Specifically, the BN noted that:

> As a common carrier subject to the Interstate Commerce Act, Railroad can issue securities only with the approval of the Interstate Commerce Commission and only for a carrier purpose. Such limitations prohibit Railroad from issuing securities for the acquisition or development of non-transportation assets.

Further, BN has stated:

> The authority of the ICC to grant its approval is restricted to security issuances which it finds to be reasonably necessary for or consistent with the proper performance by the railroad or service to the public as a common carrier. The practical effect of this restriction, as construed by the ICC, is to prohibit the railroad from issuing securities for the acquisition or development of non-transportation assets, thereby greatly limiting the railroad's ability to develop such assets.

Has the ICC's interpretation of its securities authority been applied so as to effectively prohibit the issuance of securities for the development of non-transportation assets?

Chairman TAYLOR. Senator, we do not think so. The railroad's authority to issue securities is subject to 49 U.S.C. 11301. Under that section, the Commission may approve an application when it finds that the securities issue, first, is for a lawful object within the corporate purpose of the carrier and reasonably appropriate for that purpose; second, is compatible with the public interest; third, is appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier; and, fourth, will not impair the financial ability of the carrier to provide this service.

The statute does not preclude issuance of securities to develop nontransportation holdings. Properly framed, I believe such an application would be granted. The Commission, however, in accordance with the statute, does carefully consider the factors set forth in section 11301 to determine whether the proposal is in fact related to a transportation purpose.

I might also mention that timing could be a consideration to the railroads. Even if the application is ultimately granted, carriers complain they can be adversely affected by a delay in issuing securities.

Senator **Baucus**. Thank you very much. I, frankly, agree with you. I read the statute. I agree that there is no prohibition except for the circumstances that you yourself mention.

Chairman **Taylor**. We believe you are correct.

Senator **Baucus**. I am also pleased by your testimony where you indicate that the Bureau of Accounts will soon be monitoring more carefully the financial transactions between carriers and affiliated companies during regular audits. As you know, GAO indicated, however, that these audits may not be enough to reveal potential problems. GAO further notes that staff might be insufficient to get the job done.

Do you have any views on what specific ways you can beef up the frequency and the quality of audits? Can you institute a more regular system of inquiry and reporting?

Chairman **Taylor**. I think we might. Mr. William F. Moss is here from our Bureau of Accounts. They have that responsibility. I have tried very, very hard in our budget problems and reducing our staff not to reduce the Bureau of Accounts because that is one of the very essential bureaus that we have for just these kinds of monitoring functions and rate matters and so on.

I personally feel that we probably could do more than we are doing. I have already indicated to our staff people that we are going to do everything we can to make sure there is an effective effort made.

As far as any details are concerned and how many individuals are involved and what specific efforts are made now and how that might be improved, if I might, I would like to ask Mr. Moss to respond to that. Perhaps he can give you some more specifics.

Senator **Baucus**. Certainly.

Mr. **Moss**. Thank you, Mr. Chairman. As was mentioned by GAO, we do have audit procedures on a 2- or 3-year basis. However, as Chairman Taylor has indicated, he has a strong interest in the holding company problems. Probably what we are going to end up doing is switching some of the frequencies in order to more closely monitor the holding company procedures.

Senator **Baucus**. In addition to frequencies, is there anything else?

Mr. **Moss**. We have in our normal audit process a program where we look for the dissipation of working capital, inequitable income tax allocation, unreasonable fees, and deferral of carrier maintenance. We are in the process right now and we have told our audit people in the field to come forward with some suggestions so that we can expand in these areas.

Senator **Baucus**. Would it be possible for you to report back to this committee what those additional suggestions are or what additional measures either the Commission or the staff is proposing? [1]

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[1] See material submitted in the appendix at page 593.

Chairman TAYLOR. It certainly would, Senator, if you will give us 30 days to do it so that it will be meaningful and we can give it appropriate attention.

Senator BAUCUS. That 30 days will be fine. I would appreciate that very much.

Chairman TAYLOR. We will do it for the record.

Senator BAUCUS. Are you considering the possibility of initiating or proceeding to seek testimony on holding company transactions?

Chairman TAYLOR. Not at the moment we are not. I have got so much on my plate at the moment. That is one thing we may look at eventually, but there are no specific plans at the moment.

Senator BAUCUS. I understand your staff indicated to the GAO that the Commission does not have the authority to halt or limit transactions which might adversely affect a railroad's financial stability. Your testimony notes that the Commission previously did seek such authority. Are you currently seeking authority in that area?

Chairman TAYLOR. Are you talking about the 1970 draft legislation that was submitted? Is that what you have in mind?

Senator BAUCUS. That is correct.

Chairman TAYLOR. I inquired about this a day or so ago. Apparently, as I understand it, no action was taken on that. So, it has just been left sitting. We have not made any effort to resubmit it, at least in the 9 months that I have been at the ICC. But that is certainly something that we can have a look at. To the extent that you are interested in our doing so, we would be glad to work with you on it.

Senator BAUCUS. I would appreciate your looking at it and giving us your best judgment as to whether you think it does make sense to proceed.

Chairman TAYLOR. All right, sir, we would be glad to.

Senator BAUCUS. What would happen if you discovered an abuse you had no authority to correct? How long do you suppose it would take to obtain authority from Congress, for Congress to give you authority to do something about that?

Chairman TAYLOR. I am one who feels that we have to work very, very closely with Congress. We are an arm of the Congress operating under delegated authority. We are developing a whole legislative program in the regulatory reform area and trying to consult with people on the Hill on it on a continuing basis.

I think we would come up here right away. We would have some suggestions ready very quickly. Ms. Rosenak has had a lot of experience in drafting legislation. I think if we saw an abuse I would contact her, and both of us would come up here; and we would try and get something done. Beyond that, I do not know what action Congress might take, but we would do our best.

Senator BAUCUS. I encourage you to do that. If you do find abuse—it may be hard for you to find it, given certain constraints. But, if you do, I strongly suggest that you do come to the Congress and to the appropriate committees and very quickly.

In 1979, Chairman O'Neal testified before the Antitrust Subcommittee that the Commission was concentrating on daily paper shuffling, that ICC was making decisions as they came up and that no one was stepping back to get an overall picture of what the agency was doing in the rail merger area. He went on to indicate that the Commission was contracting an overall review of past merger decisions including the 1970 BN merger. According to GAO, the study was undertaken but was completed in "substantially limited" scope.

I know you were not around at the time. Do you know why this Still/Kornhauser study, as it was called, was never submitted to the committee?

Chairman **Taylor**. Is that the so-called Princeton study?

Senator **Baucus**. Yes; it is.

Chairman **Taylor**. I have not seen that myself. I have not had a chance to review it or evaluate it. My staff people have advised me that they thought it was rather inconclusive and really did not show a great deal. I am sure that if it is available somewhere at the Commission, and I understand it is, we can submit it to you for the record. As far as Chairman O'Neal's comments about how mergers are handled, I am quite proud of the fact that one of the fellows who served on my staff and who is sitting on my left, Lou Gitomer, is taking over now as the head of the Section of Finance. I think I can assure you that, at least as long as I am at the ICC, finance applications are not going to be a paper-shuffling operation. They are going to be given very, very serious consideration.

I might ask Mr. Gitomer in terms of staffing and personnel to comment on whether he feels, as I have indicated, I think, in a general fashion, that we are capable of performing that function in an adequate manner.

Mr. **Gitomer**. Mr. Chairman, we have developed a system at the Commission for handling major rail consolidations. We developed a multidisciplinary team drawn from numerous offices throughout the Commission so that we will have expertise on that team to weigh and judge all of the allegations made by the proponents of a consolidation. In that way we can insure that the record which is presented to the Commission for decision is accurate. We believe that, even with our staff cutbacks, the rail consolidation area is of sufficient importance that we will draw people from other projects, put other projects on the back burner so that these consolidations can be handled in a very expeditious and accurate manner. Thank you.

Senator **Baucus**. I am going to put portions of that Still/Kornhauser study in the record so that all of us have a better opportunity to know what it says.

[Material referred to follows:]

80-TR-4

STUDIES IN RAILROAD MERGERS:

INVESTIGATION OF HISTORICAL TRAFFIC DIVERSIONS AND REGULATORY MERGER CONDITIONS

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Final Report to the Interstate Commerce Commission on Contract ICC-79-R-0015

TRANSPORTATION PROGRAM PRINCETON UNIVERSITY

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1. INTRODUCTION

The past five years have seen a renewed interest in railroad restructuring. The bankruptcy of the Penn Central led to legislation to simplify the regulatory procedure for the evaluation and approval of restructuring proposals. These laws, the Regional Rail Reorganization (3R) Act of 1973 and the Railroad Revitalization and Regulatory Reform (4R) Act of 1976, have led to numerous proposals for restucturing. The inability of Conrail; the Chicago, Rock Island, and Pacific; and the Chicago, Milwaukee, St.Paul, and Pacific to sustain profits have led to many serious discussions of controlled transfers, controlled liquidations, and acquisitions. In addition, many financially stable railroads are currently engaged in merger proceedings or preliminary talks. Take for example the BN-Frisco merger currently before the Commission, or the merger currently being considered between the Union Pacific and Missouri Pacific.

All of these actions, whether they be enacted for the stabilization of financially strapped railroads, or the viability of healthy railroads, will have significant impacts on traffic routings over the U.S. rail network. It is evident that a great need exists for analytical models which can accurately predict the re-routings of traffic (traffic diversion), due to network restructuring. In addition, it is time for the Commission to re-examine its policies in dealing with railroad consolidations, particularly with regard to the imposition of traffic conditions for the protection of adversely affected railroads.

This research examined these two important issues, namely (1) the development of traffic redistribution models (traffic diversion models), and (2) the examination of protective traffic conditions.

1.1 REGULATION OF RAILROAD CONSOLIDATIONS

The Transportaion Act of 1920 first gave the Interstate Commerce Commission jurisdiction over railroad consolidations. Previous to this, anti-trust laws provided the only means of halting mergers which were potentially adverse to the best interests of the railroad industry. The 1920 Act required that the Commission should only approve those mergers or acquisitions which (a) were found to be in the public interest and (b) were found to be consistent with a master plan of consolidation to be devised by the Commission. The spirit of the legislation was to encourage consolidation of railroads into a few large and powerful competitive systems, which was believed to be in the overall interest of efficient transportation.

The master plan was not completed until 1929. Unfortunately, the great depression was at hand and many carriers did not feel the master plan was in their best interest. The Transportation Act failed to produce the significant railroad consolidations it had intended

The next major legislation with regard to railroad consolidation was the Transportation Act of 1940. The requirement that consolidations should conform to the Commission's master plan was dropped. Secondly, the requirement that all consolidations shall be consistent with the public interest was made more explicit, in that the following factors had to be considered by the Commission:

1. The effect of the transaction upon adequate transportation service to the public.

2. The effect of the inclusion or failure to include other railroads in the territory involved in the proposed transaction.

3. The total fixed charges resulting from the proposed transaction.

4. The interest of the carrier employees involved.

Since 1940, the only major legislation concerning railroad consolidations has been the recent 3R and 4R Acts (previously cited). The major purpose of the 3R Act was to deal with the several bankrupt railroads in the northeast by consolidating them into competitive systems (principally Conrail and the Delevare and Hudson). The 4R Act provided several regulatory reforms with regard to consolidation, most notably the requirement that merger proceedings before the Commission should be completed within 240 days and that a decision should be reached within 180 days. Observing the 14 years of merger proceedings in the Burlington Northern case, these requirements produced a major improvement in the regulatory process.

1.2 MOTIVATIONS FOR RAILROAD MERGER

A major part of the merger proceedings before the Commission has been the presentation and discussion of projected cost savings and revenue increases that are expected to accrue to the applicants as a result of merger. Cost savings are often said to result from the elimination of duplicate facilities, predominantly in cases were the applicants serve similar areas. Unit cost savings are also said to accrue from economies of scale as the railroads combine output under a single corporate umbrella. Despite these claims, an examination of past mergers reveals that elimination of duplicate facilities, (yards, lines, and work forces) does not often occur. Political intervention on behalf of shippers and labor unions is a predominant reason in addition to operational considerations of the merged railroads. In addition very little evidence can be found to support the

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existence of economies of scale in the railroad industry. In fact, diseconomies of scale are often shown to predominate(1).

In the absence of cost savings, the major motivation for railroad mergers is concluded to be the gaining of revenue through the capture of competitor's traffic. As is stated in *Railroad Consolidation*, Professor Julius Grodinsky states,

> The basic idea underlying the consolidation movement is a traffic problem; not financial; not operating...Consolidations are made in response to...thse forces which enable the acquiring road to capture the business of the acquired road, to force its movement over the line of the acquiring road and away from its competitors... For consolidation inevitably must disturb traffic interchange between connections. This very disturbance is the prime purpose and effect of consolidation(2).

A few examples serve to illistrate traffic diversions (traffic redistribution) due to railroad mergers.

Example 1: Montgomery, Ala. to Miami, Fla.

Figure 1 portrays the relation of the Seaboard Air Line (SAL), Atlantic Coast Line (ACL), and the Florida East Coast (FEC) Railroads previous to the late 1960's in the Montgomery, Ala. to Miami, Fla. market. SAL and ACL were strong competitors throughout the South. In this market, the SAL was able to offer single carrier service, since it served both market endpoints. In order for the ACL to compete with the SAL, it cooperated with the FEC (which served Miami) in the establishment of through rates comparable to those of the SAL. Given the merger of of the ACL and SAL, it was evident that the merged carrier would prefer to use the old SAL route in this market. In so doing, most traffic that was originated on the old ACL was, as a result of merger, subject to diversion from the FEC. The merged carrier, as a result of these traffic diversions, was able to enjoy more revenue than the combined revenues of the ACL and SAL.

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(1) See Meyer, Peck, Stenason, and Zwick, *The Economics of Competition in the Transportation Industries*, Harvard University Press, 1959.

(2) Julius Grodinsky, *Railroad Consolidation*, D. Appleton, 1930, p.xv.

Example 2: Chicago to Portland, Ore. Market

Two major routes were offered in the Chicago to Portland market prior to the late 1960s. (See Figure 2). The Chicago, Burlington, and Quincy (CBQ), the Great Northern(GN), and the Spokane, Portland, and Seattle (SPS) cooperated in providing an efficient northern route. The Union Pacific (UP) with the cooperation of several carriers between Chicago and Omaha, notably the Chicago and Northwestern, and the Chicago, Milwaukee, St. Paul, and Pacific (Milwaukee), competed to the south. In 1968, the ICC approved the merger of the CBQ,GN,SPS, and the Northern Pacific. The effect in this market was the establishment of single-carrier service via the northern route, which effectively improved service

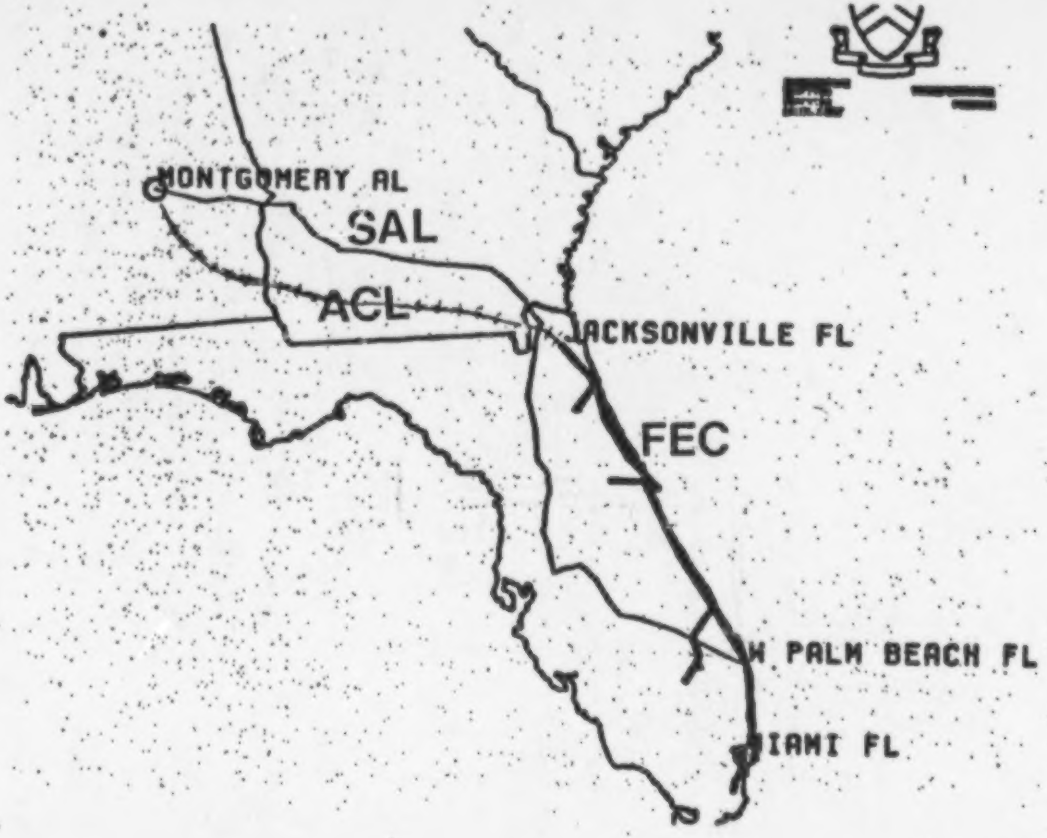
MONTGOMERY AL
SAL
ACL
JACKSONVILLE FL
FEC
W PALM BEACH FL
MIAMI FL

FIGURE 1: THE MONTGOMERY TO MIAMI MARKET

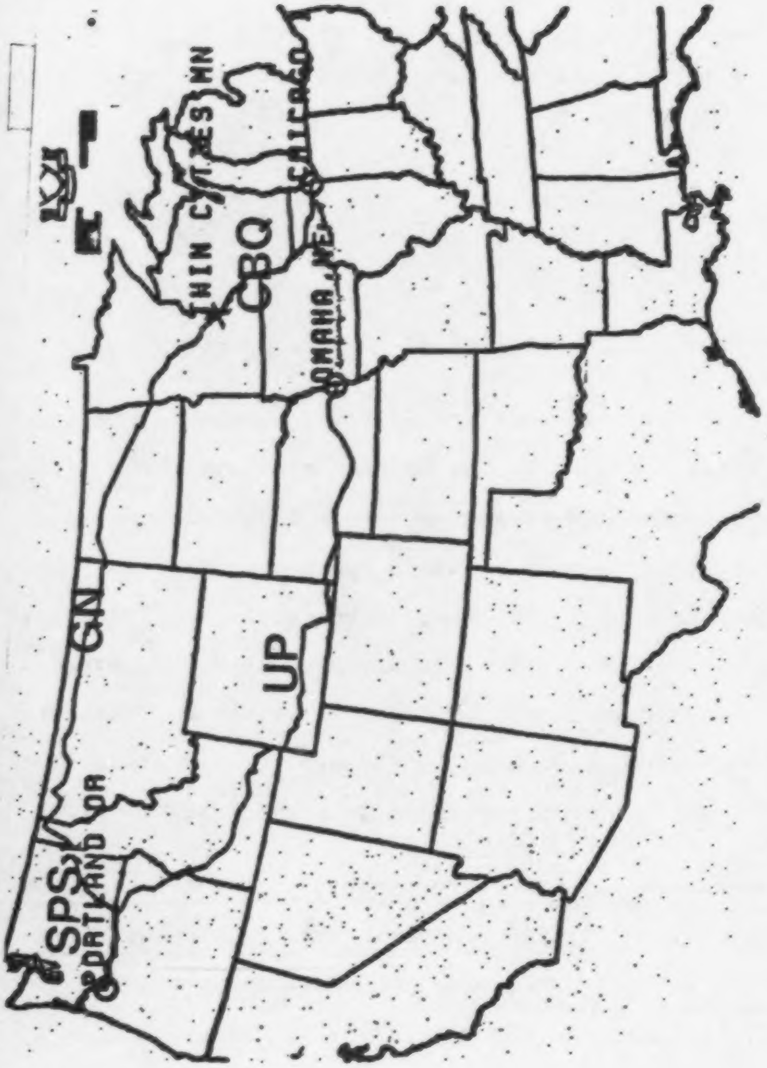
SPS
PORTLAND OR
GN
UP
OMAHA NE
CBQ
TWIN CITIES MN
CHICAGO

FIGURE 2: THE CHICAGO TO PORTLAND MARKET

and provided the incentives for traffic (revenue) diversion away from the multi-carrier southern route. The diversionary consequences of the creation of new local service will be discussed later.

Such examples illistrate the principles of traffic (and revenue) diversion.

1.3 TRAFFIC DIVERSION STUDIES AS PART OF MERGER PROCEEDINGS

As has traditionally been an important aspect of the merger proceedings before the Comission, the applicant railroads present traffic diversion studies. These analyses present the expected revenue losses of competitors as the result of merger. In addition, other railroads, usually those adversely affected by the proposed merger, present their own traffic studies. As can be expected, traffic diversion estimates presented by the applicants are seldom similar to those of the interveners (opposing railroads).

There is in general a great deal of uncertainty about the reliability of traffic diversion analyses, regardless of the source; applicants or interveners. Professor Richard Saunders in *Railroad Mergers and the Coming of Conrail* states,

> Methods of calculation (of traffic diversion studies) varied widely. Some took random samples over a long period of time; others took car-by-car samples for a short period. Some measured only selected commodities. Discrepancies were so wide that credibility was lost(3).

The Commission offered this opinion of traffic diversion studies in the Seaboard Air Line, Atlantic Coast Line merger proceedings:

> One or more of the assumptions on which the divertibility studies are predicated are of doubtful validity... While we are impressed by the thoroughness of the applicants estimates,... we believe that such estimates are somewhat understated because of the speculative nature of the assumptions on which they are based(4).

From these citations it is evident that traffic diversion studies have traditionally lacked in the following characteristics:

1. Uniformity with respect to methodology and traffic data.
2. Ability to measure system-wide impacts of merger

There is a need for a methodology that can be recognized by applicants, interveners, and the Commission as being the most appropriate in measuring traffic diversions. Such a methodology can be adopted by the railroads or by an impartial authority such as the Department of Transportation. (The 4R Act does provide that the Sectretary of Transportation may conduct impartial investigations of mergers and present the results to the Commission for consideration).

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(3) Richard Saunders, Railroad Mergers and the Coming of Conrail, Greenwood Press, 1978, p. 205.

(4) 320 ICC 169.

Traffic diversion models have been developed at Princeton University which contain the desired characteristics outlined above.

2. INVESTIGATION OF HISTORICAL TRAFFIC DIVERSION

The following sections describe traffic diversion models developed at Princeton. One of these models was applied to mergers of the 1967-1972 period to investigate historical traffic diversion.

2.1 TRAFFIC DIVERSION MODELS

Two theories of railroad traffic diversion have been postulated at Princeton University:

1. The Elementary Theory of Traffic Diversion

2. The Advanced Theory of Traffic Diversion

The elementary theory is based on historical traffic flows and market shares among existing routes, and considers only incremental changes in those market shares resulting from consolidation. The advanced theory does not rely on historical routings. Instead, it assigns traffic to routes on the basis of such level of service measures as distance, track condition, and number of railroads per route. The advanced theory is required whenever there are large changes in network configuration, such as two or more mergers occurring in the same area. The elementary theory is well suited to smaller changes in network structure such as a single merger, examples being the proposed BN-Frisco merger, or the acquisition of a portion of the Rock Island by the Southern Pacific.

The elementary theory was considered to be appropriate to analyze railroad mergers in the 1967-1972 period. Therefore, the advanced theory will not be considered further in this report.

2.2 THE ELEMENTARY TRAFFIC DIVERSION MODEL

As was stated in the preceeding section, the Elementary Traffic Diversion Model assigns incremental changes to historical routings as a result of railroad consolidation. The following definitions will prove useful in the discussions that follow:

1. Market: An origin-destination pair. Both the origin and destination encompass a defined area where shippers and receivers are located. It is assumed that each railroad operating in an area has access to each of the shippers/receivers in that area through direct

sidings, terminal railroads, or reciprocal switching agreements. Analytically, such locations are defined by FRA Network node numbers or Standard Point Location Codes (SPLCs). The user has flexibility in choosing the size of the origins and destinations, however, it is recommended that these be kept as small as possible to best represent the actual competitive environment.

2. Route: A sequence of railroads and interline junctions which connect an origin and destination. Only those routes which appear in historical data are considered in the analysis, even though other routes may appear in published tariffs.

3. Merger: The functional union of two or more railroad networks, irrespective of the financial or organizational arrangements under which they are brought together.

The historical data in this analysis was the 1% waybill sample. This data provided:

1. An enumeration of all active routes.

2. The amount of traffic (loaded carloads) traveling on each route for all markets.

3. The revenue associated with shipments on each route.

2.2.1 Procedure

The Elementary Traffic Diversion model proceeds as follows:

1. Waybill statistics are used to define the before merger market shares of all routes in each market.
2. All markets and routes are classified on the basis of a hierarchy defined in Table 2 and Table 3.
3. The extent of probable diversion for each market and route type combination is provided as a user input in units of percent change in market share.
4. After merger market shares are allocated to each modified route in each market. This traffic is assigned to the new railroad network configuration. This yields traffic flow on each link of the railroad network as well as distances which allow for the computation of new revenue divisions.
5. Comparison of all before and after values of total, as well as link by link transportation activity, indicates the differential impact on each carrier involved; both the merged railroads and their neiboring un-restructured railroads.

2.2.2 Market Type Enumeration

All markets in the historical data base are classified according to a hierarchy of market strength of the applicant (merging) railroads. Referring to Table 2, it is observed that the highest market type (market type 1) is the one in which the merging carrier offers single-carrier service prior to merger. The fact that single-carrier service has significant market power is well known and will be discussed later. Market Type 2 is that in which two or more applicants historically cooperated in providing multi-carrier service. This is an important category in that single-carrier service will be offered after merger. Other categories are presented. Notice that the weakest market power is associated with the case in which an applicant acted as overhead carrier only (market type 7).

2.2.3 Route Type Enumeration

All routes within affected markets are classified according to ownership and number of carriers. Referring to Table 3, it is observed that route type 1 represents all single-carrier routes of a merging carrier; market type 2 represents all single-carrier routes of a non-merging carrier. The remaining classifications represent multiple-carrier routes which may or may not involve the merging carriers.

TABLE 1: MARKET TYPE ENUMERATION

Market Type	Characteristics
1	Observed Target Single-carrier
2	Target Originates Does (of may) Terminate
3	Target Originates Only
4	Target May Originate Target Does Terminate
5	Target May Originate Target May Terminate
6	Target Cannot Originate Target Does Terminate
7	Target Overhead Only

TABLE 2: ROUTE TYPE ENUMERATION

Route Type	Characteristics
1	Target Single Carrier
2	Other Single Carrier
3	Multiple-Carrier Target Originates
4	Multiple Carrier Target Orinates
5	Multiple Carrier Target Overhead
6	Multiple Carrier Target Terminates

2.2.4 Matrix of Diversion Coefficients

The seven market type classifications and six route type classifications produce a matrix of 42 market and route type combinations, all of which have different associated diversionary consequences. It is in this part of the model that the user inputs a set of diversion coefficients, which from his own experience, he expects to be reasonable. For example, the user may decide that the highest diversionary coefficients should be assigned to market type 2, route types 2 through 6, in the expectation that the new single-carrier service will significantly divert traffic away from competitors.

2.3 INVESTIGATION OF HISTORICAL DIVERSION

Even though the Elementary Traffic Diversion Model contains great flexibility in that the user supplies the diversion inputs, it was not previously known what coefficients were reasonable in terms of past merger experience. This section of the research used historical data and the Elementary Traffic Diversion model to calculate a set of diversion coefficients which best represent the traffic diversions observed in mergers in the 1967-1972 period. Table 3 lists the mergers condsidered.

Investigation of diversion was limited to the markets in which single-carrier service was created as the result of merger. Although this limited the analysis to market types

TABLE 3: MERGERS EXAMINED IN THE 1967-1973 PERIOD

Merger	Component Carriers
Family Lines System (FLS)	Atlantic Coast Line (ACL) Seaboard Air Line (SAL) Louisville and Nashville (L&N) Chicago & Eastern Ill. (C&EI) Monon
Penn Central (PC)	Pennsylvania (PRR) New York Central (NYC) New York, New Haven & Hartford (NH)
Burlington Northern (BN)	Chicago, Burlington, and Quincy (CBQ) Great Northern (GN) Northern Pacific (NP) Spokane, Portland, and Seattle (SPS)

Noted in O'Neil testimony p. 31

1 and 2, the diversionary consequences of the creation of single-line service are known to be major in relation to those found in other market types.

2.3.1 Importance of Single-Line Service

As has been stated, the diversionary consequences of new single-line service are known to be significant, particularly in those markets where competitive single-line service did not exist prior to merger.

Professor Grodinsky states,

> It is the operation of trains, principally in their transfer from the tracks of one road to those of another, that the greatest opportunity for a breakdown in service exists. And here exists, therefore, the opportunity to render a superior service capable of meeting that afforded by the one-line hauls.... Its trains need not be detained at junction points; no interchange records are needed; no switching to and from foreign tracks is required... (5)

It can be expected, therefore, especially in markets where no single-carrier routes were offered previous to merger, that the creation of single-carrier service will have significant diversionary consequences, i.e., traffic will be diverted to the new single-carrier route.

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(5) Grodinsky, p. 113.

2.3.2 Data Bases

Two sets of data were used in the historical investigation of traffic diversion. The 1966 1% waybill sample was used to obtain traffic patterns before merger and the 1973 1% sample was used to obtain after merger routings.

The 1966 waybill sample contained some deficiencies which are worthy of note.

1. Routings were defined only by origin and destination railroad. No intermediate railroad or junction information was provided. This precluded the analysis of route type 5 (a route in which a merging railroad acts as overhead carrier).

2. Origins and destinations were not defined by 6-digit Standard Point Location Codes (SPLC) as was the case with subsequent waybill samples (1973-1978). The 1966 data base used 6-digit Association of American Railroads (AAR) location codes. In defining "before" and "after" markets, the assumption was made that 6-digit AAR location codes described locations comparable in size to those of 6-digit SPLCs.

At first glance there appeared to be no means of corresponding 1966 markets to 1973 markets due to the different location codes. Fortunately, a scheme was developed to do this translation using Freight Station Accounting Codes (FSACs). The 1966 sample contained FSAC information for each origin and destination. A 1967 FSAC Directory was obtained which provided the correspondence between FSAC and SPLC. In this manner, 6-digit AAR location codes were translated into SPLCs using FSACs as the intermediaries.

2.3.3 Market Enumeration Procedure

This section outlines the procedure for the enumeration of those markets potentially affected by traffic diversions. Since the analysis was limited to traffic diversions resulting from the creation of new single-carrier service, the search for affected markets was reduced considerably.

1. An algorithm was used to locate all routes in the 1966 Waybill sample that originated traffic on one merging carrier and terminated traffic on another. For example, all routes that originated traffic on the Pennsylvania Railroad and terminated traffic on the New York Central (or the converse) were located. After merger, these routes became single-carrier routes.

   It was required that such routes have at least five carloads to be considered for further analysis.

2. All routes competing with those found in step 1 were located. In this manner, all "before merger" markets

were now enumerated with regard to the potential new single-carrier service. It was required that these markets have at least 15 carloads to be considered in further analysis.

3. The "before markets" found above were translated from six digit AAR location codes to six digit SPLCs using the procedure previously outlined. Next, all 1973 "after merger" markets were found that corresponded to "before merger" markets. This completed the market enumeration process.

2.3.4 Market Enumeration Results

Sixty-nine significant markets (more than 15 records/market) were found in the 1966 Waybill sample. Of these, 34 corresponding significant markets were found in the 1973 Waybill Sample. The following table presents the number of significant markets found for each merger:

I. Before Merger (1966 1% Waybill Sample)

Merger		Number of Significant Markets
Burlington Northern		17
Family Lines System		20
Penn Central		30
Illinois Central Gulf		2
	total	69

II. After Merger (1973 1% Waybill Sample)

Merger		Number of Significant Markets
Burlington Northern		10
Family Lines System		12
Penn Central		12
Illinois Central Gulf		0
	total	34

The fact that a significant market in 1973 could not be located for every 1966 market is due to the following:

1. It is a well known statistical fact that the number of observations of a given characteristic vary from sample to sample. For example, given that 5,000 carloads were actually shipped between Chicago and Seattle in a given year, repeated 1% samples of U.S. rail traffic may show 60 observations between Chicago and Seattle in one sample, 40 observations in another, 50 in another,etc. Consequently, there exists the likelihood that several marginally significant markets in 1966 may have become insignificant in 1973 purely due to variation in observations per sample.

2. Traffic patterns changed between 1966 and 1973. This is in part due to competition from other modes, producer and consumer relocation, and changes in railroad operations and physical plant.

2.3.5 Calculation of Diversion Coefficients

Diversion coefficients in the Elementary Traffic Diversion Model are defined in units of percent loss (gain) in market share, i.e.:

$$\frac{\Delta \text{ MS}}{\text{MS Before}} = \frac{\text{MS Before} - \text{MS After}}{\text{MS Before}}$$

Where MS = Market Share

The following was the procedure used for calculating diversion coefficients (See Example 1).

1. Markets were classified by market type. In this case, only market types 1 and 2 existed due to the specifics of the market enumeration procedure.

2. All routes were classified by route type.

3. Market share was calculated within each market by route type.

4. Percent loss (gain) in market share for each route type between 1966 and 1973 was calculated, resulting in the disaggregate diversion coefficients.

5. All diversion coefficients of a given route type were averaged. (Weighted averages were actually used. Weights were number of carloads per market.) In this manner, a single diversion coefficient was found for each market type/route type combination.

EXAMPLE 1: SAMPLE CALCULATION OF DIVERSION

Chicago to Atlanta: Market Type 2

Before Route (1966)	Cars	Route Type
C&EI - L&N	29	1
C&EI - ACL	9	1
C&O - SOU	15	3
C&EI - Cen. of GA.	12	4
IC - SAL	5	6
After Route (1973)		
FLS local	60	1
C&O - SOU	6	3
C&O - FLS	5	6

Compiled Results:

Route Type	Before Market Share	After Market Share	% Change
1	.55	.85	.53
3	.21	.08	-.62
4	.17	.00	-1.00
6	.07	.07	.00

6. A confidence interval was constructed for each market type route type combination, thus providing a probability statement about the expected true values of the diversion parameters.

2.3.6 Results

There was an insufficient number of markets to calculate a set of diversion coefficients for each merger, therefore the following aggregate results are presented:

Market Type I

Route Type	Diversion Coefficient (% Change in MS) 1966-1973	95% Confidence Limits
1	.44	.42, .46
2	-.17	-.06, -.29
3	-.86	-.81, -.90
4	-.70	-.65, -.75
6	-.97	-.96, -.99

Market Type II

1	.36	.33, .39
2	-.40	-.32, -.48
3	-.52	-.44, -.59
4	-.21	-.02, -.40
6	-.66	-.56, -.75

1. Route Type 1:

In both Market types 1 and 2, market share on the new single-carrier routes was shown to increase by about 40% over pre-merger multi-carrier or single-carrier service offered by merging carriers. The source of these traffic gains was diversion from other route types.

2. Route Type 2

In market type 1, competing local routes were shown to lose about 15% of their pre-merger market share, while in market type 2, losses were about 40%. Greater losses occured in market type 2 since single-carrier service competition did not exist prior to merger.

3. Route Type 3

As expected, multicarrier service of non-merging carriers was shown to lose significantly to new single-carrier service created by merger.

4. Route Type 4

Losses in this route type were smaller than those for other multicarrier routes. Quite the opposite was expected, however. The merged carrier should have been reluctant to only originate traffic when in these cases, it had the ability to terminate as well. The existence of this shorthauling can be attributed to retaliation on the part of shippers and competing railroads.

5. Route Type 6

As expected, losses in this route type were very large an can be attributed to two sources:

a) Traffic was diverted from these multicarrier routes to the local service created by merger.

b) The originating carriers, in retaliation, found other terminting cariers with whom to cooperate.

Coefficients for route types 3,4, and 6 were shown to be higher for market type 1 than market type 2. This was contrary to intuition since it was expected that the creation of new single-carrier service would have only a moderate impact in these cases where single-carrier service existed before. This can be explained, however. Market shares for these route types were generally very small previous to merger (often about five percent). After merger, these market shares were often zero. Even though total losses in traffic were relatively small, the loss in market share from 5% to

0% is a 100% loss. It was this 100% that was used as the input for the calculation of diversion coefficients. In market type 2, however, market share of these route types was relatively large before merger, and was not often reduced by 100% after merger.

2.4 CONCLUSIONS WITH REGARD TO HISTORICAL TRAFFIC DIVERSION ANALYSIS

The diversion coefficients calculated represent a set of mergers with many similar characteristics, namely:

Reasons applicability of methodology is limited:

1. All mergers considered (BN, PC, FLS), were basically of the parallel type. That is, these railroads generally competed with each other in the same markets.
2. All mergers occurred in the same time period (1967-1972) and consequently experienced similar regulatory and external economic environments.

For these reasons, it was not believed to be in error to calculate an aggregate set of coefficients for all mergers.

The major question arises, however, as to how applicable these coefficents are to other mergers, namely those currently before the ICC, those being planned by railroads, or those not yet conceived. To some extent this remains an open question. It was not concluded what effect such factors as geography, railroad size, merger type, or time have on diversion coefficients. However, the coefficients do provide an estimate of expected ranges of diversion. Since no unbiased post-merger study of traffic diversion had occured previously, these estimates certainly represent an improvement.

The information presented in conjunction with the Elementary Traffic Diversion Model can be effectively used by regulators to evaluate traffic diversion studies presented in merger proceedings before the Commission.

3. EFFECTIVENESS OF REGULATORY TRAFFIC CONDITIONS

As was demonstrated in the preceeding sections, railroad mergers are effective in diverting traffic and revenues away from competing carriers. These diversions may be so significant as to to destroy the financial well-being of some competing railroads (particularly the smaller ones), which is clearly not in the public interest. It has ,therefore, been the long-standing (since 1920) policy of the Commission to establish conditions for mergers which cushion the impact of traffic diversion.

As has been stated by the Commission,

> Absent protective conditions, the ability of the merged company to divert traffic at various interchange points would pose a threat of substantial injury to a number of competing railroads(6).

In all recent mergers, the Commission has levied standard traffic and routing conditions, so called D.T.&I. conditions(7), in addition to other conditions specifically relating to each merger.

In essence, these standard traffic and routing conditions require:

1. There shall be kept open all routes and channels of trade via existing junctions and gateways.
2. Whatever neutrality exists in the present handling of traffic shall be constrained so as to permit equal opportunity for service for all carriers without discrimination in routing, movement, or scheduling of traffic.
3. The present traffic and operating relationships shall be constrained and whenever possible, the promptness and frequency of handling of all cars shall be without discrimination.

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(6) 320 ICC 206

(7) Conditions of this kind were first imposed in DT&I Control 275 ICC 455 (1950).

4. No restraint shall be applied to industries to prevent them from routing traffic over any or all existing routes and gateways.

5. The applicants shall refrain from closing any existing route or channel of trade with any carrier on account of its control.

It was the intent of this research, making use of 20/20 hindsight and 1% waybill samples, to evaluate the effectiveness of these traffic conditions. Several case studies were undertaken in this regard and chosen to represent different time periods and geographies. The following is a list of the case studies considered:

1. Southern Pacific control of the Central Pacific in 1923.

2. The New Haven Railroad inclusion in the Penn Central merger.

3. Florida East Coast Railway as affected by the Seaboard Coast Line merger.

4. Milwaukee Road as affected by the Burlington Northern merger.

5. Burlington Northern routing conditions concerning the Bieber gateway.

3.1 THE CENTRAL PACIFIC CONDITIONS

The Central Pacific conditions were imposed at the outcome of a long series of events surrounding the Central Pacific Railroad.

3.1.1 Background

The Central Pacific (CP) was the western link of the first transcontinental railroad built in U.S. The builders of the CP, the so-called Pacific Associates, subsequently went on to build the Southern Pacific (SP) which tended to divert traffic away from the Ogden gateway. E.H. Harriman, who had controlling interest in the Union Pacific (UP), sought to purchase the SP, to maintain Ogden's viability, a move which was found to be in violation of anti-trust laws (United States v. Union Pacific, 226 us 61 (1912)). Subsequently, the SP was ordered to give up the CP since it was found its control could lead to the ruin of the UP (United States v. Southern Pacific, 259 US 214 (1927)). Later, it was determined that the CP could not survive alone so the ICC let the SP retain possession of the CP under the condition that all traffic moving from Oregon and northern California to points west of an arc from Niagara Falls, New York to Wheeling, West Virginia be routed via Ogden (Control of Central Pacific by Southern Pacific, 76 ICC 508 (1923)). It is these traffic conditions that were of interest in this study. (See Appendix I).

3.1.2 Monitoring the Adherence to the CP Conditions

The 1% waybill sample was used to determine the degree to which Southern Pacific adhered to the CP conditions imposed in 76 ICC 508 (1923). An examination of all waybill records originating in northern California (SPLC 87) on the SP and terminating in the Chicago area (SPLC 38) produced the following results:

1. 93% of all SP originated traffic from northern California to the Chicago area was routed via Ogden, (90 out of 97 records).

2. Of the remaining 7% (7 records) not routed via Ogden,

   a) 3 records showed routing via East St. Louis

   b) One showed routing via Tucumcari

   c) One showed routing via Pening, New Mexico

   d) One showed routing via Stockton, Calif.

Without question, the Southern Pacific was shown to be adhering to the traffic conditions imposed by the ICC as part of 76 ICC 508 (1923). The few carloads not routed via Ogden can be explained in terms of shipper preference. It is very clear from this examination that it is the policy of the SP to route its northern California traffic via Ogden.

3.2 CONDITIONS REGARDING THE NEW HAVEN INCLUSION IN THE PENN CENTRAL MERGER

The New York, New Haven and Hartford Railroad (New Haven) was, as were many other railroads in the northeast, undergoing financial crisis in the late 60's. The New Haven feared that the merger of the Pennsylvania and the New York Central would insure its downfall since the PC's New England traffic would be routed via the NYC's affiliate, the Boston and Albany. The New Haven, with Robert Kennedy as an ally, saw to it that the New Haven would be included in the Penn Central Merger or else the Department of Justice would find the PC merger to be in violation of anti-trust laws.(8) The New Haven inclusion in the PC merger plans brought many northeast railroads before the Commission to seek assurances that traffic would not be diverted away from certain key gateways. (Maybrook, in southern New York, was a particular bone of contention for the protesting railroads).

For the protection of these railroads, namely the Central of New Jersey, Reading, Western Maryland, Boston and Maine, Delaware and Hudson, and Erie Lackawanna, the ICC imposed traffic conditions (331 ICC 752 (1967)) which essentially required: (See Appendix II).

1. The maintenance of all existing or comparable gateways.

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(8) Saunders, p.196.

2. PC neutrality in handling New England traffic.

3. PC abstention from changing schedules or increasing travel times via all existing or comparable gateways.

3.2.1 Monitoring the Adherence to the New Haven Inclusion Conditions

Flatly stated, the PC ignored the conditions imposed by the Commission. It immediately changed schedules so as to put certian gateways such as Maybrook at a disatvantage to PC's Selkirk gateway, and rerouted New England traffic away from certain gateways. Maybrook lost nearly 60% of its traffic within a year of the PC merger. (9)

3.3 DIVERSIONARY CONSEQUENCES OF THE SEABOARD COAST LINE MERGER ON THE FLORIDA EAST COAST RAILWAY

As was illistrated in Figure 2, the Florida East Coast (FEC) was subject to potentially large diversions as the result of the Seaboard Coast Line (SCL) merger. Previous to merger, FEC depended heavily on an ACL interchange at Jacksonville for traffic terminating south of West Palm Beach, Fla. Since this area was also served by the SAL, it was clear that the SAL/ACL merger would pose a threat to the Jacksonville gateway since SCL could offer single-line service to south Florida.

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(9) Saunders, p.296, and 338 ICC 516.

3.3.1 Conditions Imposed By the Commission

In the SCL merger, the ICC applied standard traffic and routing conditions (DT&I conditions) in the interest of maintaining the Jacksonville gateway. However, shortly after completing the merger, SCL began the process of closing Jacksonville to FEC interchange. The following table lists interchange traffic between FEC and SCL for the years 1973-1976.(10)

	1973	1974	1975	1976
Received by FEC from SCL	63470	54868	40111	40401
Forwarded by FEC to SCL	19696	18698	14263	15966

As a result of the apparent violation in the merger conditions, FEC filed a petition with the ICC in February of 1977. The Commission found that the SCL was in fact guilty of violating conditions 1,2,3 and 5 set forth in the ACL/SAL merger report (See Appendix III). SCL was ordered to cease and desist from these violations. Subsequently, several private agreements were established between SCL and FEC to guarantee the viability of the Jacksonville gateway beyond the standard traffic and routing conditions.(11)

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(10) Finance Docket 21215, p.20.

(11) Financial Docket 21215, Appendix C.

3.4 DIVERSIONARY CONSEQUENCES OF THE BURLINGTON NORTHERN MERGER ON THE MILWAUKEE ROAD

The financial well-being of the Chicago, Milwaukee, St. Paul, and Pacific Railroad was in doubt from the beginning. The Pacific extension was completed in 1906 after horrifying cost overruns. Most damaging to the Milwaukee was the closing of all gateways with the Northern Lines (NP,GN) west of the Twin Cities. The primary effect of this policy was that the Milwaukee had to accept extreme shorthauls in many markets.(12) Consider for instance, the Chicago to Portland market. Traffic solicited by the Milwaukee out of Chicago bound for Portland had to be interchanged at St. Paul, even though potential gateways (closed) existed in Washington State. (Closed gateways are those through which joint rates are not established). The financial performance of the Milwaukee continued to be dismal throughout the century. The merger of the Northern lines was considered to be a fatal blow to the Milwaukee ,barring the approval of several conditions requested by the railroad.

The Commission found it in the public interest to grant the Milwaukee virtually all of the conditions it had requested as part of the Bulington Northern merger proceedings, formost among these being: (See Appendix IV).

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(12) Saunders, p.156.

1. Establishment of through routes and joint rates via the new gateways of Fargo and Linton, N.D.; Miles City, Judith Gap, Great Falls, Bozeman, Butte, and Missoula, Montana; Spokane, Seattle, and Tacoma, Washington.

2. Trackage rights over the BN into Portland, Oregon.

3.4.1 Adherence to the Milwaukee Conditions

The effectiveness of the above conditions was guaged using 1% waybill samples. A combined 1976-1977 waybill sample was used to establish junction activity between the BN and Milwaukee at gateways provided in the traffic conditions. The following table lists those results:

GATEWAY	1% Carloads BN to MILW	1% Carloads MILW-BN	Annualized Cars
Fargo N.D.	8	1	603
Linton N.D.	0	1	67
Miles City Mt.	11	2	871
Bozeman Mt.	0	0	0
Butte Mt.	0	0	0
Missoula Mt.	0	0	0
Great Falls Mt.	1	6	469
Judith Gap Mt.	0	0	0
Spokane Wa.	8	25	2211
Seattle Wa.	2	6	469
Tacoma Wa.	5	6	737

The results indicate that several of these gateways were in fact opened as required in the merger conditions.

Several were not?

Also analyzed was the effect of granting traffic rights to the Milwaukee into Portland. An examination of 1973 waybill data produced the following results:

1. Milwaukee single-line service produced 12% of the market share in the Chicago to Portland market. BN single-carrier service captured 40% of this market.
2. Milwaukee originated 5 sample carloads in Portland as opposed to 31 for the BN.
3. Milwaukee terminated 40 sample carloads in Portland as opposed to 117 for the BN.

These data indicate that the Milwaukee is given free access into Portland as required by the conditions of the BN merger. Higher traffic levels for the BN can be explained in terms of superior service (travel time, travel time reliability, etc.).

3.5 BURLINGTON NORTHERN CONDITIONS CONCERNING THE BIEBER GATEWAY

The routing conditions imposed in the BN merger made it clear that traffic originated on the Western Pacific (WP) or the Sante Fe and terminated on the Burlington Northern, should be routed via the Inside Route, i.e. through Bieber or Klamath Falls, Oregon and NOT through Portland. (See conditions 10 and 11 of Appendix IV).

3.5.1 Adherence to the Inside Route Conditions

Traffic between northern California and Washington State was examined in the 1973 1% waybill sample to confirm the adherence to these conditions. The following results were obtained:

1. Of 22 total carloads originated on the Sante Fe in California and terminated on the BN in Washington, all traffic, save one carload, was routed via Bieber, Oregon.
2. Of 31 total carloads originated on the Western Pacific in California and terminated on the BN in Washington, all traffic was routed via Bieber, Oregon.

Without doubt, it was shown to be the policy of the railroads involved to solicit for the Inside Route via Bieber.

3.6 CONCLUSIONS ON THE EFFECTIVENESS OF THE TRAFFIC CONDITIONS IMPOSED BY THE COMMISSION

Much can be concluded from these case studies of traffic conditions imposed by the ICC.

Authors Note: Appears to assure only written specific "gateways" were used.

3.6.1 Failure of the PC and SCL Conditions

It is evident that in the interest of profit maximization, railroads are not likely to adhere to merger conditions if they warrant the operation of routes or gateways that are deemed inferior in terms of overall quality and/or revenue generating ability.

Could be a policy consideration
But is a limited sample -!.

The failure of the PC to use Maybrook and the New York Harbor as gateways to New England has so demonstrated. It was clear from the outset that Selkirk was to be the heart of the PC system. It was not prudent to maintain other gateways when Selkirk was the logical candidate for interchanging traffic to the PC's most efficient routes, the water level route and the Boston and Albany route into New England.

Similar conclusions are reached with regard to the failure of the SCL merger conditions to maintain SCL interchange with the FEC at Jacksonville. It was not in the profit maximizing interest of the SCL to interchange traffic with the FEC at Jacksonville when in many cases it could complete these movements itself.

The PC and SCL cases have demonstrated that even with the impostion of protective conditions, merged railroads are willing to violate them in the expectation that the economies gained often outweigh the idemnities levied by the Commission.

[illegible] can
ICC [illegible] but frustrate.

3.6.2 Success of the CP and BN Conditions

The apparent success of the Central Pacific conditions stems from the fact that the central SP-UP route through Ogden is by far the best route in terms of service (travel time, travel time reliability, etc.) from northern California and Oregon to the Chicago and St.Louis gateways. Even though SP would enjoy more revenue by routing through its Southern route and the Cotton Belt to St. Louis, the additional circuity tends to make this an unpopular choice among shippers.

Similarly, with regard to the the Burlington Northern merger, the Bieber gateway was the most likely interchange between the Western Pacific and the Burlington Northern. The requirement that this gateway be used for specified traffic was not contrary to rational railoading.

3.6.3 Specificity in Routing Conditions

The failure of the PC conditions with regard to the New Haven Inclusion and the SCL conditions with regard to the Jacksonville gateway was also due in part to the lack of specificity in the standard routing and traffic conditions (DT&I conditions). It is too general and nebulous a condition to require the maintenance of all existing or comparable gateways. In several instances in the PC merger proceedings, the interveners wanted Maybrook and the New York Harbor specifically mentioned in the conditions. The failure of the Commission to favor this request may have been interpreted by the PC as a reluctance on the part of the ICC to forcefully administer the conditions.

A similar conclusion can be reached with regard to SCL merger conditions. The failure of the Commission to make specific mention of the FEC in relation to the Jacksonville gateway may have led to the effective closing of this gateway.

In short, the track record of DT&I conditions has not been impressive in the curbing of traffic diversions. To the contrary, those conditions that are specific with regard to railroads, gateways, etc., have experienced much greater success.

The CP conditions were well defined and left little doubt as to how the SP was to route its northern California and Oregon traffic. Similar evidence is also provided by an examination of the BN merger conditions with regard to the Milwaukee. These conditions were very specific and left little doubt as to which gateways were to be opened or which traffic rights were to be observed.

3.7 MERGER CONDITIONS AND PUBLIC POLICY

The major motivation for mergers is to realize certain benefits through improvements in intra-railroad routings and diversion of traffic from competitors. The Commission should not remove the incentives for merger by making merger conditions overly burdensome. Consolidation may be a necessary ingredient in the financial well-being of the railroad industry. The ICC should not overly impair this process, nor try to appease all those subject to traffic diversions when the global benefits of merger may far exceed the revenue losses of diversion.

Professor Conant in Railraod Mergers states,

> Any consolidation standard that requires traffic to move over previously existing routes should be eliminated. The diversion of traffic from some of the existing routes to more efficient routes is one key economic purpose of mergers and is clearly inconsistent with the maintenance of traffic levels on existing routes.(13)

Several sources have recommended that routing conditions should not be imposed permanently, but rather only remain for a sufficient amount of time to allow competitors to adjust to the new routings created in merger. The Rail Service Planning Office of the ICC said in the Rail Merger Study

> Neither the industry, nor the economy is static and as changes occur, the underlying rationale for requiring the conditions initially may no longer be valid. Consequently, the Office recommends that the Commission systematically review the conditions it imposed and either enforce their compliance, or if changing circumstances warrant, reduce or eliminate them.(14)

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(13) Michael Conant, Railroad Mergers and Abandonments, University of California Press, 1964, p.89.

(14) Cited in FD 21215 p. 51-52.

It is clearly a time for the Commission to re-examine its policies with regard to merger conditions. A recommendation of this study is that *the standard traffic conditions (DT&I conditions) should be replaced by those that are more specific with regard to railroads, gateways, and routes.* These conditions will be more easily interpreted by the railroads and more easily monitored and enforced by the Commission.

APPENDIX I

THE CENTRAL PACIFIC CONDITIONS

INTERSTATE COMMERCE COMMISSION REPORTS.

CONTROL OF CENTRAL PACIFIC BY SOUTHERN PACIFIC.

ORDER.

Entered February 6, 1923.

A hearing in this proceeding and investigation of the matters and things involved therein having been had, and the commission having, on the date hereof, made and filed a report containing its findings of fact and conclusions thereon, which said report is hereby referred to and made a part hereof:

1. *It is ordered*, That acquisition by the Southern Pacific Company of control of the Central Pacific Railway by ownership of the capital stock of the Central Pacific Railway Company and under and in accordance with the terms of the proposed lease, as described in the application and report aforesaid be, and the same is hereby, approved and authorized; *provided and upon condition, however*,

(*a*) That the Southern Pacific Company shall join with the Union Pacific Railroad Company in maintaining *via* the lines of said companies between Omaha, Nebr., and San Francisco Bay points, as parts of one connected continuous line, through passenger, mail, express, and freight-train service between San Francisco or Oakland, Calif., and Chicago, Ill., at least equal in every respect to that afforded by either with its connections between Los Angeles, Calif., or Portland, Oreg., and Chicago, Ill.;

(*b*) That the Southern Pacific Company shall join with the Union Pacific Railroad Company in maintaining via the lines of said companies between Roseville, Calif., and Omaha, Nebr., as parts of one connected continuous line, perishable freight-train service from Roseville, Calif., to Chicago, Ill., at least equal in point of time to that afforded by either with its connections from San Bernardino, or Colton, Calif., to Chicago, Ill.;

(*c*) That the Southern Pacific Company shall cooperate with the Union Pacific Railroad Company in the maintenance of train schedules under which neither shall discriminate as to time or service against the other in favor of any other connection through Ogden or Salt Lake City, Utah;

(*d*) That the Southern Pacific Company shall at the request of the Union Pacific Railroad Company provide for the publication and maintenance of rates *via* the Central Pacific Railway through Ogden, Utah, between all points on the lines of the Southern Pacific Company and Central Pacific Railway Company in California, west of Banning, and in Oregon on the one hand and Colorado common points and points east thereof on the other, no higher than apply concurrently between the same points *via* any other route in which it participates;

(*e*) That the Southern Pacific Company shall cooperate with the Union Pacific Railroad Company to secure by active solicitation the routing of the maximum of freight traffic *via* the lines of the Union Pacific Railroad Company and the Central Pacific Railway Company through the Missouri River and Ogden, Utah, as parts of one connected continuous line, between all points in California and Oregon north of and including Caliente and Santa Margarita, Calif., and south of and including the Klamath Falls branch and Kirk, Oreg., on the one hand, and points north and west of a line along the northern boundaries of Oklahoma and Arkansas, to the Mississippi River, thence along the Mississippi and Ohio Rivers (but not including intermediate cities on the Ohio River) to Wheeling, W. Va., and thence on a line drawn just east of Pittsburgh, Pa., and Buffalo, N. Y., to Niagara Falls, N. Y.;

(*f*) That the aforesaid lease shall contain a provision that the same shall become null and void and of no effect whenever this commission shall find that the control, acquisition of which is herein approved and authorized, interferes with the consummation of the complete plan of consolidation adopted and published under the provisions of section 5 of the interstate commerce act, as amended;

(*g*) That the control herein authorized by lease and stock ownership shall be held subject to termination by order of this commission if and when found by this commission to interfere with the consummation of its complete plan of consolidation under the provisions of section 5 of the interstate commerce act and for this purpose the commission reserves full jurisdiction over the case to make such order or orders as, after hearing, it may deem to be necessary and appropriate;

(*h*) That the Southern Pacific Company shall not voluntarily sell, pledge, or otherwise dispose of the capital stock of the Central Pacific Railway Company or any part thereof without the consent of this commission, except that any existing pledge of such stock may be ratified and confirmed;

(*i*) That this proceeding may be reopened at any time by order of the commission either upon the initiative of the commission or, in the discretion of the commission, upon the motion of any person claiming an interest in the matter, for the purpose of making such orders as the commission may deem necessary or appropriate supplementary to the present order;

2. *And it is further ordered*, That the Southern Pacific Company shall file with this commission at least 10 days before the execution of said lease a copy thereof substantially in the form in which it is proposed to execute the same.

APPENDIX II

TRAFFIC CONDITIONS IMPOSED ON THE NEW HAVEN INCLUSION IN THE PENN CENTRAL MERGER

APPENDIX I

Upon inclusion of the NH in the transaction authorized by the Interstate Commerce Commission in Finance Docket No. 21989:

1. Penn-Central, WM, Reading, and CNJ, as to traffic moving to and from all stations on or reached via the lines of the NH, to or from stations on the lines of WM, Reading, and CNJ, shall with respect to each other maintain and keep open existing or comparable routes and channels of trade in full vigor as fast competitive service routes via existing or comparable junctions or gateways, unless and until otherwise authorized by the Interstate Commerce Commission.

2. The present neutrality of handling traffic inbound and outbound by NH shall be continued by Penn-Central, insofar as such matters are within its control, so as to permit equal opportunity for service to and from the lines of WM, Reading, and CNJ without discrimination as to routing or movement of traffic and without discrimination in the arrangement of schedules or otherwise. Likewise, the present neutrality of handling traffic inbound and outbound by WM, Reading, and CNJ shall be continued so as to permit equal opportunity for service to and from the lines of NH included in Penn-Central without discrimination as to routing or movement of traffic and without discrimination in the arrangement of schedules or otherwise.

3. The present traffic and operating relationships existing between NH, on the one hand, and WM, Reading, and CNJ, on the other, shall be continued insofar as such matters are within the control of Penn-Central, on the one hand, and WM, Reading, or CNJ, on the other.

4. Insofar as such matters are within its control, Penn-Central shall, as to the lines of NH included in the transaction authorized in Finance Docket No. 21989, accept, handle, and deliver all cars inbound and outbound, loaded and empty, without discrimination in service as between cars destined to or received from WM, Reading, and CNJ, and irrespective of destination or route of movement. Likewise, WM, Reading, and CNJ shall accept, handle and deliver all cars inbound and outbound, loaded and empty, without discrimination in service as between cars destined to or received from the lines of NH included in the transaction authorized in Finance Docket No. 21989 and carriers competing with said latter lines of Penn-Central, and irrespective of destination or route of movement.

5. Penn-Central shall not do anything to restrain or curtail the right of industries now located on the lines of NH to route traffic over existing or comparable routes and gateways in connection with WM, Reading, or CNJ. Likewise, neither WM, Reading, nor CNJ shall do anything to restrain or curtail the right of industries now located on its lines to route traffic over existing or comparable routes and gateways in connection with the lines of the NH included in the transaction authorized in Finance Docket No. 21989.

6. Insofar as such matters are within their control, Penn-Central, on the one hand, and WM, Reading, and CNJ, on the other, shall cooperate with each other and each shall use its best efforts with its connections to obtain similar cooperation in order to continue the NH-CNJ-Reading-WM route as a competitive service route for the movement of freight traffic between points located on or beyond NH's lines and points located on or beyond WM's, Reading's, and CNJ's lines, endeavoring at all time to improve such service and maintaining at least the same standards of service as prevail on the date of the consummation of the Penn-Central merger; and neither WM, Reading, or CNJ, on the one hand, nor Penn-Central, on the other, shall, without the written consent of the other, make any substantial change in train schedules or take any other action, the effect of which would be to increase the time in transit via the aforesaid routes, or to otherwise adversely affect the standards of service; provided, however, that if all other obligations of these conditions have been complied with, this paragraph shall not be construed to require the maintenance of train service or schedules if revenues from operations via the aforementioned joint routes during any 6 months' period have been insufficient to cover out-of-pocket costs.

7. With respect to traffic presently handled jointly by the NH, on the one hand, and the CNJ, Reading, or WM, on the other, Penn-Central, WM, Reading, and CNJ will, insofar as such matters are within their control, continue to publish or concur in publication of rates so that rates to or from points on or reached via WM, Reading, or the CNJ routes will always be competitive with other routes and as to the aforesaid traffic they shall also concur in divisions of such rates under the established bases of divisions, and in the event of any reductions in joint rates proportionate reductions shall be made in the divisions of Penn-Central.

8. Insofar as such matters are within their control, Penn-Central, on the one hand, and WM, Reading, and CNJ, on the other, will cooperate in continuing the solicitation of that traffic in which the NH now participates over routes via WM, Reading, or CNJ having competitive rates and services.

9. Any party or person having an interest in the subject matter may at any further time make application to the Commission for such modification of the above conditions, or any of them, as may be required in the public interest, and jurisdiction shall be retained by the Commission to reopen the proceeding on its own motion for the same purpose.

10. These conditions shall be contingent upon and shall take effect on the date of consummation of the Penn-Central merger authorized in Finance Docket No. 21989 and upon their acceptance by WM, Reading, and CNJ, evidenced in writing to the Commission.

Source: 331 ICC 752-753

REVISED APPENDIX I

Upon inclusion of the NH in the transaction authorized by the Interstate Commerce Commission in Finance Docket No. 21989 effective as of the date of consummation of the Penn-Central merger:

1. Penn-Central, WM, Reading, and CNJ, as to traffic moving to and from all stations on or reached via the lines of the NH, to or from stations on or reached via the lines of WM, Reading, and CNJ, shall with respect to each other maintain and keep open existing or comparable routes and channels of trade in full vigor as fast competitive service routes via existing or comparable junctions or gateways, unless and until otherwise authorized by the Interstate Commerce Commission.

2. The present neutrality of handling traffic inbound and outbound by NH shall be continued by Penn-Central, insofar as such matters are within its control, so as to permit equal opportunity for service to and from the lines of WM, Reading, and CNJ without discrimination as to routing or movement of traffic and without discrimination in the arrangement of schedules or otherwise. Likewise, the present neutrality of handling traffic inbound and outbound by WM, Reading, and CNJ shall be continued so as to permit equal opportunity for service to and from the lines of NH included in Penn-Central without discrimination as to routing or movement of traffic and without discrimination in the arrangement of schedules or otherwise.

3. The present traffic and operating relationships existing between NH, on the one hand, and WM, Reading, and CNJ, on the other, shall be continued insofar as such matters are within the control of Penn-Central, on the one hand, and WM, Reading, or CNJ, on the other.

4. Insofar as such matters are within its control, Penn-Central shall, as to the lines of NH included in the transaction authorized in Finance Docket No. 21989, accept, handle, and deliver all cars inbound and outbound, loaded and empty, without discrimination in service as between cars destined to or received from WM, Reading, and CNJ, and carriers competing with WM, Reading, and CNJ, and irrespective of destination or route of movement. Likewise, WM, Reading, and CNJ shall accept, handle and deliver all cars inbound and outbound, loaded and empty, without discrimination in service as between cars destined to or received from the lines of NH included in the transaction authorized in Finance Docket No. 21989 and carriers competing with said latter lines of Penn-Central, and irrespective of destination or route of movement.

5. Penn-Central shall not do anything to restrain or curtail the right of industries now located on the lines of NH to route traffic over existing or comparable routes and gateways in connection with WM, Reading, or CNJ. Likewise, neither WM, Reading, nor CNJ shall do anything to restrain or curtail the right of industries now located on its lines to route traffic over existing or comparable routes and gateways in connection with the lines of the NH included in the transaction authorized in Finance Docket No. 21989.

6. Insofar as such matters are within their control, Penn-Central, on the one hand, and WM, Reading, and CNJ, on the other, shall cooperate with each other and each shall use its best efforts with its connections to obtain similar cooperation in order to continue the NH-CNJ-Reading-WM route as a competitive service route for the movement of freight traffic between points located on or beyond NH's lines and points located on or beyond WM's, Reading's, and CNJ's lines, endeavoring at all times to improve such service and maintaining at least the same standards of service as prevail on the date of the consummation of the Penn-Central merger; and neither WM, Reading, or CNJ, on the one hand, nor Penn-Central, on the other, shall without the written consent of the other, make any substantial change in train schedules or take any other action, the effect of which would be to increase the time

in transit via the aforesaid routes, or to otherwise adversely affect the standards of service.

7. With respect to traffic presently handled jointly by the NH, on the one hand, and, the CNJ, Reading, or WM, on the other, Penn-Central, WM, Reading, and CNJ will, insofar as such matters are within their control, continue to publish or concur in publication of rates so that rates to or from points on or reached via WM, Reading, or the CNJ routes will always be competitive with other routes, including the local routes of Penn-Central, and as to the aforesaid traffic they shall also concur in divisions of such rates under the established bases of divisions, and in the event of any reductions in joint rates proportionate reductions shall be made in the divisions of Penn-Central.

8. Insofar as such matters are within their control, Penn-Central, on the one hand, and WM, Reading, and CNJ, on the other, will cooperate in continuing the solicitation of that traffic in which the NH now participates over routes via WM, Reading, or CNJ having competitive rates and services.

9. Any party or person having an interest in the subject matter may at any further time make application to the Commission for such modification of the above conditions, or any of them, as may be required in the public interest, and jurisdiction shall be retained by the Commission to reopen the proceeding on its own motion for the same purpose.

10. These conditions shall take effect upon the inclusion of NH, effective as of the date of consummation of the Penn-Central merger authorized in Finance Docket No. 21989 and upon their acceptance by WM, Reading, and CNJ, evidenced in writing to the Commission.

11. Penn-Central, Reading, WM, and CNJ will distribute copies of this appendix, and any amendments which may from time to time be made or accurate summaries thereof, to all of their operating officers, traffic officers, and traffic representatives, in order that all operating and traffic personnel of Reading, WM, CNJ, and Penn-Central will be at all times advised of the purposes and effects of this appendix.

12. The interpretation, application and enforcement of the conditions of this appendix shall be governed exclusively by the following provisions:

A. All controversies arising under this appendix (except those relating to the modification of conditions referred to in condition 9) shall be determined with finality by the Interstate Commerce Commission in the manner indicated below. Orders of this Commission, made as provided hereinafter, shall not be reviewable in any court. Orders of this Commission determining any such controversy may be enforced by judicial order of judgment as provided in 49 U.S.C. §16.

B. (1) Whenever Reading, CNJ, or WM considers that these protective conditions are being violated, or that a violation will result from the effectuation of a tariff publication in which the merged company participates, it may (or two or more such carriers may collectively) file with the Commission, Board of Suspension, and with the merged company, a complaint verified by an appropriate official of the complainant (or of each of the complainants), containing a short and plain statement of the matters constituting the alleged violation and the relief sought.

(2) If, in the case of a complaint involving a tariff publication, such complaint shall include a prima facie showing that one of the protected car-

riers is a competitive factor as to traffic affected by such tariff, the Board of Suspension may, in the case of a tariff publication already effective, and shall in the case of a tariff publication not yet effective, forthwith suspend such tariff pending determination by the board of the issues presented by such complaint. Said board shall conduct an investigation of the matters referred to in any complaint and, if requested by any party to the controversy, shall hold a hearing. If, after such investigation and hearing, if any, said board shall find no violation of any of the conditions of this appendix, it shall thereupon order the removal of any tariff suspension theretofore imposed. If, after such investigation and hearing, if any, said board shall find a violation of any of the conditions of this appendix, it shall thereupon order the cancellation of any violative tariff provisions or, if no tariff be involved, the termination of any violative conduct.

C. (1) Final decisions as to issues raised by a complaint shall be rendered by the Board of Suspension within 90 days after the complaint is filed.

(2) Appeal shall lie to the Commission, division 2, from orders of the Board of Suspension.

(3) Special rules for proceeding before the Board of Suspension and appealing therefrom shall be promulgated by this Commission at a future time. Such rules shall include provisions which afford to the merged company and to protected carriers full and adequate opportunity to reply to any complaint filed under subdivision B and to present evidence, briefs and argument as to all issues.

D. Consummation of the NH inclusion transaction shall constitute, on the part of the merged Penn-Central and NH, their successors and assigns, acquiescence in and assent to the conditions stated in this appendix without seeking judicial review.

Source: 331 ICC 764-767

APPENDIX III

SEABOARD COAST LINE

MERGER CONDITIONS

APPENDIX XI

Routing and gateway conditions

1. Upon consummation of the merger, the Seaboard Coast Line Railroad Company shall maintain and keep open all routes and channels of trade via existing junctions and gateways, unless and until otherwise authorized by the Interstate Commerce Commission.

2. The present neutrality of handling traffic inbound and outbound by the applicants shall be continued so as to permit equal opportunity for service to and from all lines reaching the rails of these carriers without discrimination as to routing or movement of traffic and without discrimination in the arrangement of schedules or otherwise.

3. The present traffic and operating relationships, including, among other things, interchange arrangements and switching practices, between the applicants, on the one hand, and all lines connecting with their tracks, on the other, shall be continued insofar as such matters are within the control of the Seaboard Coast Line Railroad Company.

4. Seaboard Coast Line Railroad Company shall accept, handle, and deliver all cars inbound and outbound, loaded or empty, without discrimination in promptness or frequency of service as between cars destined to or received from competing carriers, and irrespective of destination or route of movement.

5. Seaboard Coast Line Railroad Company shall not do anything to restrain or curtail the right of industries now located on lines of the applicants to route traffic over any or all existing routes and gateways.

6. Seaboard Coast Line Railroad Company shall preserve and maintain the same schedules on the present freight trains of Seaboard and Coast Line which the merged company would continue after consummation of the merger; unless such schedules, after revision, would provide later departure times and/or earlier arrival times at junctions and gateways in such a manner that the existing cutoff times for connecting trains of other railroads would not be changed, or, would not cause or permit such connections to be delayed or broken.

7. Seaboard Coast Line Railroad and its connections shall open new routes, and maintain thereover competitive joint rates and just and equitable divisions thereof in connection with Norfolk Southern Railway Company via Wilson, N. C., via Fayetteville, N. C., and via Raleigh, N. C., on all traffic moving between (i) all stations on the Seaboard Coast Line Railroad Company and its connections south of Norfolk Southern's line, on the one hand, and (ii) Norfolk, Va., and points in official territory located in the Buffalo-Pittsburgh, eastern trunk line, and New England territories, including, Canada, on the other; provided, that this condition shall be in effect only as long as Norfolk Southern remains an independent railroad.

8. Seaboard Coast Line Railroad Company shall, as to all traffic (except traffic restricted by the terms of the existing Hardeeville-Jacksonville trackage agreements), be required to maintain, in connection with the Southern and its affiliates to and from the Jacksonville gateway, joint rates no higher than the rates applicable over the lines of the merged company through that, or any other, gateway: Provided, however, that Southern and its affiliates will extend

similar reciprocity to the merged company with respect to all traffic interchanged by Southern or its affiliates at the Jacksonville gateway.

9. At the request of Southern Railway Company, presented in writing not more than 12 months after the date of consummation of the merger authorized herein, or not more than 12 months after the effective date of any certificate of the Commission permitting abandonment by Seaboard Coast Line Railroad Company of any line of railroad directly affecting the lines described in this condition, Seaboard Coast Line Railroad Company shall cancel the existing trackage agreements under which Southern Railway operates over lines of the Atlantic Coast Line Railroad Company, between Hardeeville, S. C., and Jacksonville, Fla., and shall refrain from opposing or in any manner protesting any request by Southern Railway for permission under section 1(18)-(20) to abandon operations pursuant to the aforesaid trackage agreements.

10. At the request of Southern Railway Company, presented in writing not more than 6 months after the date of consummation of the merger authorized herein, or, not more than 6 months after the effective date of any certificate of the Commission permitting abandonment by Seaboard Coast Line Railroad Company of any line of railroad directly affecting the lines described in this condition, Seaboard Coast Line Railroad Company shall cancel the existing trackage agreements under which Southern Railway operates over lines of the Atlantic Coast Line Railroad Company between Selma, N. C., and Pinners Point, Va.; and shall refrain from opposing or in any manner protesting any request by Southern Railway for permission under section 1(18)-(20), to abandon operations pursuant to the aforesaid trackage agreements.

11. Seaboard Coast Line Railroad Company shall be required to transfer to the Southern Railway Company, by sale or long-term lease, or the grant of trackage rights, or a combination thereof, a line of railroad from a connection with the Southern Railway in Jacksonville to the mill of St. Regis Paper Company at Quinlan, Fla., upon such terms as the carriers may agree or, in the event of their disagreement, upon such terms as the Commission may, after subsequent hearing, find to be just and reasonable, all subject to the approval of the Commission upon the filing of an appropriate application.

12. Seaboard Coast Line Railroad Company shall be required to grant trackage rights to the Central of Georgia Railway Company over the track of the merged company between Albany and Tifton, Ga., upon such terms as the carriers may agree, or, in the event of their disagreement, upon such terms as the Commission may, after subsequent hearing, find to be just and reasonable, all subject to the approval of the Commission upon the filing of an appropriate application: Provided, however, that this condition shall be null and void unless the Central of Georgia Railway Company requests such trackage rights within 1 year from the date of consummation of the merger herein authorized.

13. Any party or person having an interest in the subject matter herein, at any future time, may make application for such modification of the conditions prescribed as part of the authorization herein, or any of them, as may be required in the public interest; and jurisdiction will be retained by the Commission to reopen the proceeding herein on its own motion for the same purpose.

14. The Commission will retain jurisdiction for a period of five years following the date of consummation of the merger to permit the filing of petitions by the carriers by railroad specified in the report herein, for inclusion in the transaction. The Seaboard Coast Line Railroad Company will be required

negotiate in good faith with respect to the proposals for inclusion presented to it by such petitioning railroads and to cooperate to the fullest extent in the compilation of an adequate record to provide a basis for the required determination by this Commission as to whether such transaction would be consistent with the public interest. In the event the parties are unable to agree, and the Commission after hearing concludes that the transaction would be consistent with the public interest, it will issue an order directing the Seaboard Coast Line Railroad Company to include the petitioning railroad upon such terms and conditions as the Commission finds to be just and reasonable.

APPENDIX XII

Present and proposed sinking fund requirements on Coast Line's bonds of series A, B, C, and D

The present sinking fund requirements with respect to Coast Line's bonds of series A, B, C, and D are provided for in the first, second, third, and fifth supplemental indentures, respectively, to Coast Line's general mortgage dated March 1, 1950. The proposed modifications therein are set forth in a proposed modification indenture showing the specific amendments to the aforementioned supplemental indentures. The following table shows the sinking fund payments required and actually paid by Coast Line during the period 1957 to 1959, inclusive, under the present provisions of the aforesaid indentures, and the maximum amounts that would be paid by the merged company under the proposed modification indenture:

Series of bonds	Amounts required and actually paid			Principal amount bonds to be redeemed annually by merged company
	1957	1958	1959	
A	$275,360	$275,360	$275,360	$458,000
B	440,000	440,000	440,000	586,000
C	400,000	400,000	400,000	533,000
D	134,740	134,740	134,740	224,000
	1,250,100	1,250,100	1,250,100	1,801,000

As shown herein, the proposed modifications would impose a maximum limitation of $1,801,000 annually on the sinking fund payments on Coast Line's bonds of series A, B, C, and D. At present, Coast Line's sinking fund payments with respect to its series A, B, and C bonds are contingent upon a percent of its net income, while those on series D bonds are fixed amounts. With respect to series A bonds, Coast Line is required to pay the greater of 12.5 percent of its net income for the preceding calendar year, or all net income for sinking fund purposes for the preceding calendar year, but not in excess of [illegible]. Any sinking fund payment not in excess of 1 percent ($275,360) of the maximum principal amount of series A bonds, which at any one time have been [illegible], may be made in series A bonds. Under the proposed modification, the merged company would pay annually, in cash, a sinking fund payment, to the [illegible] 100 percent of net income for the preceding calendar year is [illegible] therefor, an amount sufficient to redeem $458,000 principal amount

APPENDIX IV

BURLINGTON NORTHERN

MERGER CONDITIONS

APPENDIX I

1. Upon consummation of the transaction in whole or in part, NuCo shall maintain and keep open all routes and channels of trade via existing junctions and gateways, unless otherwise mutually agreed upon by the carriers affected or otherwise authorized by this Commission.

2. The present neutrality of handling inbound, outbound and overhead traffic by the merged and leased railroads shall be continued by NuCo so as to permit equal opportunity for service to, from, and via all lines reaching its rails without discrimination as to routing or movement of traffic and without discrimination in the arrangement of schedules or otherwise.

3. Existing traffic and operating relationships, including contracts, between any of the merged and leased railroads, on the one hand, and, on the other, all lines connecting with their tracks, shall be continued insofar as such matters are within the control of NuCo.

4. NuCo shall accept, handle and deliver all cars inbound and outbound and in overhead or switching service, loaded and empty, without discrimination in promptness or frequency of service and irrespective of origin or destination or route of movement.

5. NuCo shall do nothing to restrain or curtail the right of industries served by it or the merged and leased lines to route traffic over any or all available routes and gateways.

6. Any party or any person having an interest in the subject matter may, at any future time, make application for such modification of the above conditions, or any of them, as may be required in the public interest, and jurisdiction will be retained by this Commission to reopen these proceedings pursuant thereto or on our own motion.

7. NuCo and Southern Pacific shall join in the establishment and maintenance of joint through rates via Klamath Falls, Oreg., on bases no less favorable than via other routes, on all traffic to and from points on their lines, and their short-line connections. NuCo shall observe strict neutrality between the Bieber, Calif., and Klamath Falls gateways as to solicitation of traffic, regardless of origin or destination. NuCo and Southern Pacific shall conduct operations without discrimination or limitation, including the furnishing of specialized equipment, switching services, and the maintenance of train schedules so as to handle traffic interchanged between them at Klamath Falls in a prompt and expeditious manner and in no respect with less favorable treatment than is accorded by NuCo on traffic handled via Bieber or by Southern Pacific on traffic handled via Portland, Oreg.

8. NuCo and Southern Pacific shall establish and maintain joint through rates via Portland to and from all points to the same extent as hereafter established via Klamath Falls and shall conduct operations via Portland without discrimination or limitation, including the furnishing of specialized equipment, switching services and maintenance of train schedules, said service to be equal or superior to that presently provided by Northern Pacific and Southern Pacific in operating via Portland.

9. Southern Pacific, following the effectuation of condition 24 hereinafter, shall solicit all traffic to and from Oregon, Washington, northern Idaho and British Columbia, as follows:

(a) From and to territory north of Los Angeles, Calif., Southern Pacific shall observe strict neutrality between Union Pacific, NuCo and the Milwaukee.

(b) From and to territory Los Angeles and south and east thereof served in common by Union Pacific and Southern Pacific and where Union Pacific now maintains or may maintain rates via its Salt Lake line that are competitive with Southern Pacific through Portland, Southern Pacific shall solicit all traffic in favor of NuCo and the Milwaukee, without preference as between them.

(c) From and to territory Los Angeles and south and east thereof except as provided in paragraph (b), immediately above, Southern Pacific shall observe strict neutrality between Union Pacific, NuCo and the Milwaukee.

10. NuCo and Western Pacific shall join with each other and with Santa Fe in establishing and maintaining joint through rates via Bieber, Calif., on bases no less favorable than via other routes, on all traffic between points in Washington, Oregon, Idaho and British Columbia located on the lines of NuCo and its connections, on the one hand, and, on the other, points on the lines of (1) Western Pacific and its short-line connections in California, Nevada and Utah; (2) points in California, Arizona, New Mexico, Texas, and Louisiana on the lines of Santa Fe and its short-line connections; and (3) Rio Grande in Utah; and on transcontinental traffic between points other than those described above, the rates via Bieber shall be maintained on bases equal to the rates applicable via all other routes between points on the lines of NuCo and all transcontinental origins or destinations to the same extent as provided via Bieber in Trans-Continental Freight Bureau Tariff No. 5 series, I.C.C. 1576.

11. With respect to all traffic described in paragraph 10, via routes from, to, or through California, NuCo shall preferentially solicit for its Inside Route (i.e., via either Klamath Falls, Oreg., or Bieber) and shall not by any means, including the adjustment of divisions of freight revenue, give preference to its route via Portland; and NuCo and Western Pacific shall observe practices, including those with respect to solicitation and the adjustment of divisions of freight revenue, which will afford to the Bieber route no less favorable an opportunity than the Klamath Falls route to share in the traffic moving between the areas described in paragraph 10, immediately above. As used in this paragraph, the term Klamath Falls route or gateway includes, and the provisions thereof shall cover traffic interchanged at Chemult, Oreg., a point on the Klamath Falls route.

12. NuCo and Western Pacific shall conduct operations via Bieber without discrimination or limitation, including the furnishing of specialized equipment, switching services, and the maintenance of train schedules so as to handle traffic interchanged between them there in a prompt and expeditious manner and NuCo shall accord such traffic no less favorable treatment than it accords traffic interchanged with connecting lines at Klamath Falls, Chemult, or Portland.

13. Western Pacific shall solicit all traffic to and from Oregon, Washington, northern Idaho and British Columbia via the Bieber route and in favor of NuCo and the Milwaukee, without preference as between them.

14. NuCo and Santa Fe (and its Texas subsidiaries) shall join with each other and with Western Pacific in establishing and maintaining joint through rates via Bieber on bases no less favorable than via other routes, on all traffic

between points in Washington, Oregon, Idaho, and British Columbia located on the lines of NuCo and its connections, on the one hand, and, on the other, points in California, Arizona, New Mexico, Texas and Louisiana on the lines of Santa Fe and its short-line connections; and on transcontinental traffic between points other than those described above, the rates via Bieber shall be maintained on bases equal to the rates applicable via all other routes between points on the lines of NuCo and all transcontinental origins or destinations to the same extent as provided via Bieber in Transcontinental Freight Bureau Tariff No. 5 series, I.C.C. 1576.

15. With respect to all traffic described in paragraph 14, via routes from, o, or through California, NuCo shall preferentially solicit for its Inside Route i.e., via Klamath Falls or Bieber) and shall not by any means, including the djustment of divisions of freight revenue, give preference to its route via ortland; and NuCo and Santa Fe shall observe practices, including those with espect to solicitation and the adjustment of divisions of freight revenue, which ill afford the Bieber route no less favorable an opportunity than the Klamath alls route to share in the traffic moving between the areas described in aragraph 14. As used in this paragraph, the term Klamath Falls route or ateway includes, and the provisions hereof cover, traffic interchanged at hemult, a point on the Klamath Falls route.

16. NuCo and Santa Fe shall join with Western Pacific in conducting operaions via Bieber without discrimination or limitation, including the furnishing f specialized equipment, switching services, and the maintenance of train chedules so as to handle traffic interchanged between them there in a prompt nd expeditious manner and NuCo shall accord such traffic no less favorable eatment than it accords traffic interchanged with connecting lines at Klamath alls, Chemult, or Portland.

17. NuCo shall establish and maintain joint rates with Western Pacific and its onnections, via Bieber, and with the Milwaukee, via Portland and via Vancouver, ash., between all points on the Milwaukee and its connections, on the one hand, nd, on the other, all points on Western Pacific and its connections, on bases o less favorable than shall apply from time to time via the Milwaukee and outhern Pacific via Portland.

18. NuCo shall establish and maintain joint rates with Western Pacific and s connections, via Bieber, and with Union Pacific, via Ben, Oreg., and via ancouver, Wash., between all points on Union Pacific and its connections in e Pacific Northwest, on the one hand, and, on the other, all points on Western acific and its connections, on bases no less favorable than shall apply from me to time via Union Pacific and Southern Pacific via Portland.

19. The Milwaukee, as a condition to its securing trackage rights over the nes of NuCo between Longview Junction, Wash., and Portland, Oreg., between enton and Snohomish, Wash., and between Everett and Bellingham, Wash., all:

(a) Establish and maintain joint rates via Portland, Oreg., and Vancouver, ash., with NuCo and with Western Pacific and its connections, via Bieber, tween all points located on the Milwaukee and its connections, on the one nd, and, on the other, all points on Western Pacific and its connections, on ses no less favorable than shall apply from time to time via the Milwaukee d Southern Pacific via Portland, and

(f) Maintain in connection with freight traffic moving via the Bieber route freight train schedules and service no less favorable than it shall contemporaneously maintain in connection with Southern Pacific via Portland.

20. The Milwaukee, as a condition to its securing various gateways and trackage rights herein:

(a) In connection with freight traffic moving from, to, or via any point located on its lines (or which in the future may be located on its lines or the lines of its successor as a result of merger or consolidation of trackage rights or lease or an extension of line) in Illinois, Missouri, Iowa, Wisconsin, Michigan, and Kansas, on the one hand, and, on the other, points in California north of and including Caliente and Santa Margarita, shall: (1) join with its connections in maintaining via the various central transcontinental routes freight train schedules and service at least equal in all respects to the freight train schedules and service contemporaneously maintained by the Milwaukee and its connections between such territories via any of the northern transcontinental routes, (2) join with its connections in maintaining via the various central transcontinental routes joint through rates on bases no less favorable than those which the Milwaukee shall join with its connections in maintaining via any of the northern transcontinental routes, and (3) cooperate with its western connections to secure by active solicitation the routing of the maximum of freight traffic via the various central transcontinental routes and shall route unrouted traffic via such routes, and

(b) In connection with freight traffic moving from, to, or via any points located on its lines (or which in the future may be located on the lines of its successor as a result of merger or consolidation of trackage rights or lease or an extension of line) in Illinois, Missouri, Iowa, Wisconsin, Michigan, and Kansas, on the one hand, and, on the other, points in Oregon and Washington and the Province of British Columbia, shall join with its connections in maintaining via the various central transcontinental routes joint through rates on bases no less favorable than those which the Milwaukee contemporaneously shall maintain, or shall join with its connections in maintaining, via any of the northern transcontinental routes.

21. NuCo and Soo Line shall, subject to any necessary approval of this Commission, promptly enter into and execute the agreements indicated below and shall thereafter prepare and file with this Commission any and all required applications and supporting evidence to:

(a) Amend that certain contract dated September 18, 1959, between Great Northern and Minneapolis, St. Paul & Sault Ste. Marie Railroad Company, covering coordination of certain lines of Great Northern and Soo Line between Lignite, N. Dak., and Crosby, Minn., and Hankinson and Geneseo, N. Dak., approved by order of this Commission dated January 28, 1960, in Finance Docket No. 20837, so as to give Soo Line the full and equal joint use of the "Crosby Joint Section" as that term is defined in said contract, and all spur tracks.

(b) Amend that certain contract dated July 5, 1955, between Great Northern and Minneapolis, St. Paul & Sault Ste. Marie Railroad Company, covering coordination of certain lines of Great Northern and Soo Line between [illegible] and Bemidji, Minn., and between New Aberdeen Line Junction, Minn., and Hankinson, N. Dak., approved by order of this Commission dated December 6, 1955, in F. D. No. 18992, so as to give Soo Line the full and equal joint use of the "Cass Lake Joint Section" as that term is defined in said contract, and all spur tracks.

(c) Amend that certain contract dated April 15, 1929, between Northern Pacific and Minneapolis, St. Paul & Sault Ste. Marie Railroad Company, pooling Northern Pacific and Soo Line traffic on iron ore tonnage originating on the Cuyuna Range, approved by order of this Commission dated June 3, 1929, in F. D. No. 7569 (154 I.C.C. 279) in the following respects:

1. The first 500,000 tons of ore transported from the Cuyuna Range yearly shall be divided 75 percent Soo Line and 25 percent NuCo; tons exceeding 500,000 shall be divided equally.

2. Soo Line's share of the Cuyuna car pool will be fulfilled by Soo Line's furnishing a minimum of 375 seventy—or seventy-five-ton cars and any deficiency during the first 10 ore shipping seasons after coordination of Allouez dock shall be made up with 70-ton cars furnished by NuCo at a per diem rate of $1 during said seasons.

3. The obligation of Soo Line to pay $7,850 annually on account of abandonment of its line between Lawler and East Lake shall be canceled.

4. Soo Line shall be admitted on fair and equitable terms to the use of NuCo yards and docks at Allouez, and a rail connection will be installed at Saunders to handle Soo Line ore.

(d) Authorize Soo Line, on fair and equitable terms, to use the existing Great Northern trackage between Soo Line's Shoreham Yard and the easterly end of Great Northern's Union Yard, including necessary yard tracks, so that Soo Line can make direct interchange with The Minnesota Transfer Railway Company and the Chicago, Rock Island and Pacific Railroad Company.

22. Following consummation of the transactions for which authority under section 5(2) of the act is sought, NuCo and Soo Line shall continue their cooperative efforts to find ways and means of jointly providing improved service to the shipping public by eliminating delay and reducing costs and to that end the parties shall consider the installation of automatic interlockers at various crossings now manually operated and coordination of additional lines where practical on the basis set forth in the contracts dated September 18, 1959, and July 5, 1955, further described in paragraphs 21(a) and 21(b) above.

23. NuCo shall publish and file appropriate tariffs and routing schedules to be effective on and after the date of consummation of the merger, providing for the opening of junctions and gateways at Linton and Fargo, N. Dak., and Missoula, Mont., and Spokane, Seattle, and Tacoma, Wash., with respect to traffic moving through said junctions, at the lowest applicable rates available via the Twin Cities and Sioux City gateways (on a reciprocal basis, with the Milwaukee affording equal privileges to NuCo) with just and reasonable divisions thereof as may be agreed upon, or fixed by this Commission if such carriers cannot so agree, and the Milwaukee shall, on traffic obtained pursuant

to this condition or those in paragraph 24, below, open or keep open, in similar manner, its junctions at Twin Cities, Sioux City, and Council Bluffs with North Western, and on traffic obtained pursuant to this condition or those in paragraph 24 below, open or keep open in similar manner its junction at Twin Cities with Soo Line.

Routing via the 11 first-named gateways so opened shall be restricted to one such gateway on any single shipment, and to traffic destined to or billed for transit or stopoff at any station on the other line beyond the junction up to and including the terminal area of the next junction, except that routing via Linton and Fargo shall be provided to and from Billings and Great Falls, Mont., and stations intermediate thereto.

24. At the request of the Milwaukee, presented in writing not more than 6 months after date of consummation of the unification authorized herein or not more than 6 months after the effective date of any certificate or order of this Commission:

(a) Permitting that railroad to extend its operations to Portland, Oreg., and to acquire trackage rights over the line of NuCo between Longview Junction, Wash., and Portland, Oreg., NuCo shall grant to the Milwaukee, upon such fair and reasonable terms as the parties may agree or as determined by this Commission in the event of their inability to agree, trackage rights to operate freight trains over NuCo lines between Longview Junction and Portland, including the right to serve on an equal basis all present and future industries at Portland and intermediate points and the use of NuCo facilities at Portland necessary for the switching of traffic to other railroads and industries. NuCo shall maintain Portland as an open gateway on a reciprocal basis with the Milwaukee to the same extent as with other connecting carriers;

(b) Permitting that railroad to acquire trackage rights over the lines of NuCo between Renton and Snohomish, Wash., and between Everett and Bellingham, Wash., NuCo shall grant to the Milwaukee, upon such fair and reasonable terms as parties may agree or as determined by this Commission in the event of their inability to agree, trackage rights to operate freight trains over NuCo lines between Renton and Snohomish, and between Everett and Bellingham; and

(c) Permitting that railroad to extend its service to Billings, Mont., and the handling of its traffic by NuCo from and to Judith Gap, Miles City, and Bozeman, Mont., on the one hand, and, on the other, to, from, and through Billings, Mont., including the switching of cars to or from industries at Billings, NuCo shall impartially handle the empty and loaded cars of that railroad from, to, and through Billings as though a station on the other road, such cars to be delivered to and returned by NuCo at Miles City, Judith Gap, or Bozeman, according to the direction of the traffic, upon such fair and reasonable terms as the parties may agree or as may be determined by this Commission in the event of their inability to agree.

25. NuCo shall join with the Milwaukee in:

(a) Eliminating at their common points the dual basis of switch charges by canceling in their respective tariffs the higher switch charges required to be paid when absorbed by the line-haul carrier, and by providing in their respective tariffs for the absorption by the line-haul carrier of switch charges on all traffic, subject to a reasonable minimum carload revenue, and

(b) Reestablishing rate relationships via all routes with that railroad [illegible] by reason of this unification, the relationships of rates via such routes [illegible] rates via other routes of the component lines merged into or operated under lease by NuCo are disturbed.

26. NuCo shall (1) establish and maintain competitive joint rates and routes with North Western, reciprocally, on a reasonably related divisional basis (a) via Oakes, N. Dak., as specified in sheet 3 of appendix N-9 of the examiner's report in F. D. No. 21478, with exceptions and upon terms as mutually agreed upon between said railroads, and (b) via Crawford, Nebr., as specified in sheet 4 of appendix N-9 of the examiner's report in F. D. No. 21478, with exceptions and upon terms as mutually agreed upon by said railroads, to the extent that Great Northern, Northern Pacific, or Burlington now have or to the extent that NuCo shall have joint rates and routes (A) via Laurel-Billings, Mont., through Crawford and Ellsworth, Nebr., or (B) on traffic moving from or to former Burlington lines in Montana, Wyoming, and South Dakota through Alliance, Nebr., (2) maintain connecting service schedules and interchange service at Oakes and Crawford so as to provide an efficient and effective service to the shipping public, (3) maintain efficient and effective service between Oakes, N. Dak., and Jamestown, N. Dak., for through traffic which is reasonably consistent with the service, including schedules provided by North Western between Huron, S. Dak., and Oakes, N. Dak., and (4) pick up and set out through cars (originating or terminating at points beyond Edgement, S. Dak., or Alliance, Nebr.) at Crawford in its through trains so as to provide efficient and effective service on such through traffic.

27. NuCo shall deliver Minneapolis interchange cars to the North Western at the latter's Cedar Lake and East Minneapolis Yards separated as between the two yards as that railroad may designate, and shall accept deliveries of Minneapolis interchange traffic therefrom at NuCo's Lyndale Yard, Union Yard and Northtown Yard (when it is placed in operation).

28. NuCo shall permit North Western to operate trains between Minneapolis and St. Paul, Minn., over track now owned by Great Northern known as the "Short Line" without restriction as to character or origins and destinations of the traffic in the trains using the line, and shall subject to terms mutually agreed upon (1) offer to rescind all or any part of the contract between North Western and Northern Pacific governing use by North Western of trackage of Northern Pacific between Minneapolis (20th Avenue South) and St. Paul (otherwise known as Line A), and (2) provide for partial use of that line by North Western on mutually agreeable terms, cancellation of such agreement on 90 days' notice, and in the event of such cancellation, provide for use of alternate routes which would permit North Western equivalent service, including, but not limited to, the right for North Western and Chicago Great Western Railway Company to make direct interchange in the vicinity of St. Anthony Tower, or for North Western to provide direct service to St. Anthony Tower in the event the transactions approved in F. D. No. 23388, et al. are consummated.

29. NuCo shall (1) offer to lease to North Western, upon terms mutually agreeable, its tracks in Union Yard in Minneapolis, as follows: (a) track E-4 from its commencement on the east to a connection to be constructed at a

int approximately 800 feet west of 10th Avenue S. E., Minneapolis, and (b) tracks C-29 and C-30 from a point on the east end where they join track Q-13 to the point where they join track E-4, (2) subsequent to consummation of the unification construct a connection between the leased tracks and Great Northern main line track 1 in its yard and a connection between Great Northern tracks in the vicinity of the point where tracks C-29 and C-30 enter into track Q-13, and such other change as necessary to give North Western access to the leased tracks, and (3) after Northtown Yard is placed in operation, consider leasing track Q-13 from its point of connection with tracks C-29 and C-30 to the crossover in vicinity of St. Anthony Tower semaphore.

30. NuCo shall (1) grant such trackage rights at Duluth, Minn., to Duluth, Winnipeg & Pacific Railway, upon terms mutually agreeable, as will permit the latter to handle through traffic between the present connection of that railroad and Northern Pacific in Duluth to the connection of the North Western and Northern Pacific in Duluth, and (2) grant such trackage rights to North Western, at Head of the Lakes, upon terms mutually agreeable as will permit the latter to handle such traffic over St. Louis Bay Bridge and related facilities.

31. Railroad interveners, as beneficiaries under the conditions herein imposed upon them and upon applicants as conditions precedent or subsequent to consummation of the authority granted herein, shall cooperate with each other and with applicants in order that these conditions be given full effect. Such cooperation shall, where practicable, take the form of agreements to be entered into by the parties within 180 days from the effective date of this order, or within such other period as this Commission may specify. The failure to so cooperate shall, upon the filing of an appropriate pleading by an aggrieved party hereto, be considered by this Commission as the assent by the party failing to so cooperate to modification or cancellation of such condition or conditions benefiting such party. Nothing in this paragraph shall be deemed to affect the consummation by applicants of the authority herein granted.

32. All motor-carrier operating authority (under part II of the Interstate Commerce Act) coming under the control of NuCo as a result of these proceedings shall be amended by the addition of a condition reserving the right of this Commission to impose such future conditions as it may find necessary to insure operation in the public interest under such authority.

33. The Commission shall retain jurisdiction over these proceedings for a period of 5 years following consummation of the transactions herein authorized, for the purpose, among others, of considering petitions, under section 5(2)(d) of the act, by any railroad in the territory involved requesting inclusion in the merger so authorized. The Commission shall also retain jurisdiction over these proceedings for a period of 5 years following consummation of the transactions herein authorized to impose such just and reasonable conditions upon petition by any party in interest, or on its own motion, after hearing, as may be necessitated by any cumulative or crossover problems stemming from approval of this merger and any other transaction authorized under section 5 with respect to the territory involved. Consummation of the transactions herein authorized shall constitute irrevocable assent by applicants to the power of this Commission to impose, after hearing, such just and reasonable conditions as may be necessary or appropriate.

34. NuCo shall be required to provide employees not now covered and to the extent contemplated under section 5(2)(f) of the act with the basic protection as particularly described in the contract entered into between applicants and the Brotherhood of Locomotive Engineers and Brotherhood of Railway Trainmen. NuCo shall apprise the affected employees of the protection provided herein, as more fully set out in this report.

Senator BAUCUS. Let me just read a portion of it. Pages 4 and 5 of that study state:

> An examination of past mergers reveals that elimination of duplicate facilities, yards, lines, and work forces, does not often occur. In addition, very little evidence can be found to support the existence of economies of scale in the railroad industry. In the absence of cost savings, the major motivation for railroad mergers is concluded to be the gaining of revenue through the capture of competitors' traffic.

That is on pages 4 to 5 in that study.

Even though you, Mr. Taylor, have testified that it is your understanding that some of the study was a little tentative, I am wondering whether this conclusion of this report is correct from your point of view. That is, in the absence of cost savings, whether the major motivation for railroad mergers is the gaining of revenue through the capture of competitors' traffic?

Chairman TAYLOR. I think, in analyzing a merger case, Senator, as I think we perhaps already indicated, the Commission examines projected traffic diversions as part of our evaluation of the potential benefits and harmful effects of the consolidation.

As far as potential public benefits from traffic diversions, they may result in better service or more efficient routings. Traffic diversions can also be harmful if they are the result of the exercise of market power or if they threaten the provision of essential services by competing carriers. That, by the way, is a very important consideration to me as I, too, am from a very sparsely settled Western State.

Second, diversions are generally only one factor in rail mergers that rail merger applicants anticipate. I might refer to the recent Norfolk and Western/Southern merger, where diversions accounted for about 25 percent of the total estimated benefits.

Other factors include reduced costs through improved equipment utilization, operation over superior routes, and the consolidation of facilities and operations.

Senator BAUCUS. You are not reading from the Kornhauser report, are you?

Chairman TAYLOR. No.

Senator BAUCUS. You are giving your views as to what some of the benefits are of mergers.

The reason I asked the question is that, to the degree that the Still/Kornhauser study's conclusion is accurate, to me it suggests that there might be some need for ex-postmerger analysis. That is, if the major motivation for mergers is in fact—and it could be disputed—but if it is in fact to capture competitors' traffic, that seems to me some argument anyway that there should be some postmerger analysis.

Chairman TAYLOR. We had quite a discussion about that in preparation for this proceeding. It occurs to me there ought to be something we can do to have a look at mergers after they are consummated. However, I think I have already outlined in our summary testimony the problems involved in postmerger analysis in terms of changing circumstances and conditions. It is very difficult to set up a set of conditions under which an evaluation can be made. We are, frankly, having the same problem with the Motor Carrier Act of 1980 right now. Everybody is asking us: well, how is it doing? Well, there are the problems of the economy to take into account in making that evaluation. That alone has made it a very difficult assessment process.

It seems to me that perhaps we could do something more than we are doing now in this area. What we can devise, I do not know, but we will keep you posted.

Senator **Baucus**. The Commission's 1977 holding company study concluded that the BN is widely diversified and that the financial strength of the BN is due in large measure to the existence and development of its nonrailway assets and that the railroad is only marginally profitable standing alone. That is on pages 51 and 52 of that 1977 study.

Are these the present conclusions of the Commission? Are those ICC conclusions still valid today?

Chairman **Taylor**. I really do not think they are, Senator. I did bring along some financial data on the Burlington Northern. Perhaps I can give that to you now. The Burlington Northern during the last 5 years has generated a very strong growth in earnings. That is very apparent. Coal traffic has risen substantially. Although the railroad may have properly been considered marginal 5 years ago—and that, of course, would have been 1977—it is now certainly financially sound. I do not think we could characterize it as anything else.

Management appears to be dedicated to expanding railroad operations, as evidenced by its aggressive approach to increasing coal traffic and also its recent merger with the St. Louis-San Francisco Railroad. About $1.1 billion was invested between 1976 and 1980 to increase coal hauling capacity. A comparison of revenues and earnings during the last 5 years shows the following. First, operating revenues have risen 123.5 percent between 1977 and 1981. Second, income from railroad operations has increased from $61.5 million to $167.6 million, or a rise of 172.5 percent. Net income has also risen substantially.

In fact, I can give you some figures on net income: 1977, $74.9 million; in 1978, $113.6 million; and 1979, $175.2 million; in 1980, $222.7 million; and in 1981, $267.9 million.

I think that indicates the situation today is not like it was in 1977.

Senator **Baucus**. You indicated earlier that the Commission had not adopted that report. Does that mean that it is an old report? Is it likely to be adopted? Is it not going to be adopted?

Chairman **Taylor**. The only thing I wanted to make clear was not that we would not adopt it if given consideration. It was 5 years ago, and it has not been under consideration by the present Commission. We have a lot of new commissioners coming.

I would have no problem with submitting it to the Commission to determine what their current views on it are, particularly when we get our full complement on board which, hopefully, will be within the next month or 6 weeks.

Senator **Baucus**. The Commission studied the cost and benefits of ex-postmerger analysis. We touched on this earlier. Could you again give me your views on whether such analyses are available or proper, the extent to which they are proper?

Chairman **Taylor**. I think it is proper. It is a question of how meaningful it is, particularly on a cost-benefit basis with our somewhat limited resources. I would be perfectly willing, despite the fact that staff tells us that the Princeton study was not really all that meaningful and the difficulties that exist in connection with setting up a proper set of projections and the variables that can change those projections, to have a look at it. I feel myself, as I think I said, that there ought to be something we can do to have a look. Even though it is difficult to make a valid assessment, I would be perfectly happy to examine the possibility of exploring the after-effects.

We have some very important merger cases coming. The Norfolk-Southern, of course, is behind us, but we have got the Guilford situation up in New England. Then, of course, the most important case which the Commission may decide for some time yet, the so-called "Mop-Up" case, the Union Pacific, which is of enormous significance.

To the extent that is approved subject to conditions—and I do not want to imply there is any decision that has been made in that matter yet—I certainly would like, in terms of some of the representations that have been made, to study the effects of that consolidation.

Senator **Baucus**. Are there any staff or Commission analyses or memoranda on this subject, that is the degree to which it makes sense to proceed?

Chairman **Taylor**. I do not thank there are now, Senator.

Senator **Baucus**. But you are indicating that the Commission may look into the question?

Chairman **Taylor**. It is something that I am going to look into. That I can promise you.

Senator **Baucus**. I would appreciate it if you would do so and also provide this committee with it.

Chairman **Taylor**. Supply that for the record as well?

Senator **Baucus**. Right, a copy.

Chairman **Taylor**. We shall do so.

Senator **Baucus**. Without objection, it will be included in the record.

Senator **Baucus**. Mr. Taylor, I am soon introducing a bill to have the Commission as well as the CAB and the Federal Maritime Commission compile a study on all transportation subsidies, those that are currently provided and also those past subsidies that still affect the transportation marketplace. Do you believe that we have a good overall understanding of transportation subsidies?

Chairman **Taylor**. That you have a good understanding?

Senator **Baucus**. Do you believe that the Congress, the transportation regulatory network has a good understanding of what all of the direct and indirect transportation subsidies really are in regard to various transportation industries?

Chairman **Taylor**. I think I would have to answer that no; I do not think we do have, particularly insofar as indirect subsidies are concerned. I think we all know it goes on, and we all have a feel for it in certain areas or certain things. But, in terms of having a real handle on it, I do not think we do.

Senator **Baucus**. I appreciate that. I agree with that. That is, obviously, why I am introducing the bill. In fact, I am going to make a copy of the draft bill available in the record here, too, without objection.

[Material referred to follows:]

97th CONGRESS
2d Session

S. ______

IN THE SENATE OF THE UNITED STATES

Mr. Baucus introduced the following bill: which was read twice and referred to the Committee on ______________________

A BILL

To establish the Committee on Transportation Subsidies, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) there is hereby established the ''Committee on Transportation Subsidies'' (hereinafter referred to in this Act as the ''Committee'').

(b) The Committee shall consist of four members as follows: the Chairman of the Interstate Commerce Commission, the Chairman of the Civil Aeronautics Board, the Chairman of the Federal Maritime Commission, and the Secretary of Transportation.

(c) With the permission of agencies referred to in subsection (b) of this section, the Committee is authorized to use the facilities and personnel of such agencies to the extent necessary to carry out the provisions of this Act.

Sec. 2. (a) It shall be the duty of the Committee to compile a summary of all Federal subsidies provided to any State or local government, government agency, municipality, individual, corporation, partnership, or other business entity, for all activities related to the transportation of freight and passengers.

(b) The summary shall--

(1) include the Federal program and source of authority for all such subsidies, and the monetary amount attributable to each program,

(2) contain all applicable figures through fiscal year 1982 and future projections of the figures based upon existing law,

(3) determine the amount of such subsidies attributable to--

(A) freight services,

(B) passenger services,

(C) various modes of transportation (including in the amount of such subsidy the cost of any program necessary to administer the subsidy), and

(D) freight and passenger service within each mode of transportation.

(c) (1) For purposes of this Act, the term ''subsidies'' shall include, but not be limited to, cash or other grants, gifts, loans, loan guarantees, forgiveness of debt, purchases of securities, employment protection, financial assistance to pension funds and exemption of pension benefits from Federal income tax, Federal tax provisions benefiting a mode of transportation, land grants promoting transportation, and the transfer of any monetary value by the Federal government to any State or local government, government agency, municipality, individual, corporation, partnership, or other business entity.

(2) In determining the amount of subsidy attributable to land grants the survey shall discern the proceeds realized by railroads from the sale or lease of lands or mineral rights, the current value of the lands and mineral rights still retained by railroads, railroad affiliates or holding companies, and the income currently received by the railroads, railroad affiliates, or holding companies from the resources or other property values of such lands and rights.

Sec. 3. The Committee shall have subpena power to obtain needed information and shall have the authority to require and receive the assistance and cooperation of all appropriate departments, agencies, bureaus, and other instrumentalities of the United States, including but not limited to the Department of Transportation, Department of Interior and the Department of Defense. As a part of such study, the Secretary of Transportation shall take such action as necessary to have all applicable information, statistics, and findings published in an appropriate form.

Sec. 4. Within nine months following the date of the enactment of this Act, the Committee shall submit a report to the Congress containing the summary compiled pursuant to this Act.

Senator **Baucus**. I think it is very important, in addressing these kinds of questions with regard to holding companies and other transportation matters, for all of us in the Congress and others of us in decisionmaking forums to have as near as possible an understanding as we can of the various forms of subsidies that affect the transportation industries.

Chairman **Taylor**. I would support and I would hope the Commission would support such legislation.

Senator **Baucus**. Thank you, Mr. Taylor. Mr. Krueger, do you have any other points you want to make or rebuttals or suggestions?

Mr. **Krueger**. No, sir.

Senator **Baucus**. You are a wise man. Thank you both very much.

Chairman **Taylor**. Thank you very much, Senator.

[Material follows:]

Washington D.C. 20510
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March 31, 1982

Mr. Oliver W. Krueger
General Accounting Office
441 G Street, N.W.
Room 6804
Washington, D.C. 20548

Dear Mr. Krueger:

As a follow-up to our hearing on rail mergers on March 26, I would appreciate it very much if you could supply for the hearing record the following:

1. Additional specifics on the weaknesses of ICC's current holding company audits.

2. Additional specifics on the beneficial changes that could be made in the substance and procedure of auditing--including frequency, variables that need to be monitored, extent to which holding company itself needs to be monitored, etc.

3. Any additional views you have on alternative interpretation of ICC's holding company jurisdiction.

4. A copy of the pertinent positions of FRA's study of export rail merger benefits--mentioned by Mr. Blume in testimony.

The record of the hearing will remain open until close of business, April 25, 1982, to receive these materials.

Again, I appreciate your valuable contribution to the testimony.

With best personal regards, I am

Sincerely,

Max Baucus

As a followup to the March 26 hearing on rail mergers, you asked us to respond to the following questions in your March 31 letter.

1. Additional specifics on the weaknesses of ICC's current holding company audits.

While our analysis was not directed at assessing the adequacy of ICC's holding company audits, we did identify certain weaknesses that could impact on ICC's ability to monitor holding companies' rail-related transactions.

Within ICC's Bureau of Accounts, two sections conduct financial reviews or audits of railroad and holding company transportation-related financial transactions. The Section of Financial Analysis reviews financial reports submitted by railroads and holding companies in an attempt to determine, among other things, the financial strength of the railroads, the emphasis on track rehabilitation, and lending and borrowing practices. This section can alert the Section of Audits in the event that it finds activities which may be detrimental to the railroads. However, the financial reports submitted by railroads and holding companies are not sufficiently detailed to reliably determine if a transaction could be detrimental to the railroad. Therefore, transactions which could be detrimental to the railroad may go undetected.

The Section of Audits reviews all class I railroads with emphasis on those in financial difficulty. However, these audits are performed every 2 to 3 years.

In our opinion, the lack of detailed financial data and the infrequency of audits could lead to potential abuses of railroads going undetected.

2. Additional specifics on the beneficial changes that could be made in substance and procedure of auditing--including frequency, variables that need to be monitored, extent to which holding company itself needs to be monitored, etc.

As a general guide, we believe that ICC should comply with the auditing standards as specified in our Standards for Audits of Governmental, Organizations, Programs, Activities, and Functions (1981 Revision). These standards provide guidance when determining whether the entity has complied with laws and regulations that may have a material effect upon the financial statements. The American Institute of Certified Public Accountants standards are generally accepted for such audits and have been incorporated into this publication.

ICC's audits are neither frequent enough nor detailed enough to identify all transactions which could adversely affect a holding company's railroad subsidiaries. We believe ICC should improve its audits to correct these deficiencies.

3. Any additional views you have on alternative interpretation of ICC's holding company jurisdiction.

We recognize, as did the U.S. Court of Appeals for the Eighth Circuit and the Commissioner of ICC, that alternative interpretations are possible of ICC's jurisdiction over holding companies. However, we have no such alternative view. ICC, in its 1977 study--"Railroad Conglomerates and Other Corporate Structures"--identified an alternative interpretation. This alternative would have found ". . . that the Commission possesses the authority, under section 5(4), to designate any person acquiring control over any two railroads as a rail carrier and thus subject to the reporting, investigatory, and securities provisions of the Act." The report went on to say that such an interpretation would result in more rail holding companies being under ICC's jurisdiction than under its current "single system" interpretation.

4. A copy of the pertinent positions of FRA's study of export rail merger benefits--mentioned by Mr. Blume in testimony.

In responding to a question on postmerger studies, Mr. Blume referred to a Federal Railroad Administration, Department of Transportation study which the Transportation and Industrial Systems Center performed under a contract with FRA. The study was entitled "The Merger Between the Seaboard Air Line and Atlantic Coast Line Railroads: A Case Study" and was published in March 1979.

The study covers many aspects of the merger such as the

--identification of the parties affected by the merger and their viewpoints of the merger,

--economic characteristics for regions served by the merging railroads,

--financial information,

--operations of the merged railroads, and

--service to be provided shippers.

The merger applicants sought permission to merge in order to improve the financial condition of the combined company. The estimated maximum savings was $38.7 million over a 5-year period from the merger as well as a net cash gain of $1.3 million.

The study concluded that the operating consequences of the merger are clouded by subsequent events such as the creation of AMTRAK which relieved the merged railroad of providing passenger service, the emergence of the Family Line System, and traffic shifts. The attitudes of affected parties could not be examined with any clarity. However, the merger clearly benefited the applicants despite personnel adjustments and labor disapproval. ICC, in referring to the study, said in 1980 the potential benefits are still potential and long-term affects are too early to judge.

We are providing a copy of the study for the Committee's files.

Senator BAUCUS. Our next witness is Mr. Richard Bressler, chairman of the board of the Burlington Northern Railroad.

I wonder if, for the record, you would identify those who are accompanying you.

STATEMENT OF RICHARD M. BRESSLER, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, BURLINGTON NORTHERN, INC., ACCOMPANIED BY FRANK FARRELL, SENIOR VICE PRESIDENT AND SECRETARY, BN, INC., SEATTLE, WASH.; RICHARD GRAYSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BN RR, ST. PAUL, MINN.; ALFRED E. MICHON, VICE PRESIDENT, INTERNATIONAL, BN, INC.; FRED WINEGAR, PRESIDENT, PLUM CREEK, INC.; BRUCE ENNIS, PRESIDENT, MERIDIAN LAND AND MINERAL CO.; AND ALBRO MARTIN, OGLESBY PROFESSOR OF THE AMERICAN HERITAGE, BRADLEY UNIVERSITY

Mr. BRESSLER. Mr. Chairman, we took the opportunity to testify not only because our company, as you expressed it, is important to Montana but Montana is certainly important to us. I brought with me today the chief executives of the other companies headquartered in the State of Montana. On my right is Bruce Ennis, who is president and chief executive of Meridian Land and Mineral Co., headquartered in Billings, which is responsible for our coal and other mineral activities. Fred Winegar is president of Plum Creek, headquartered in Columbia Falls, Mont., which is responsible for our lumber, plywood, and fiberboard mills, primarily operating in the State of Montana. On my left is Dick Grayson, who is president and chief executive of the Burlington Northern Railroad. Although not headquartered in Montana but in St. Paul, it is very important, as we all know, to the State and vice versa.

Senator BAUCUS. Thank you very much. I understand you have a statement.

Mr. BRESSLER. I have a short statement.

Senator BAUCUS. Before you do that, I want to thank all of you for coming today. I know you have come great distances. It is good to see old acquaintances and friends here. I appreciate you all coming to help us out here.

Without objection, your full statement will be inserted into the record.

[Material referred to follows:]

STATEMENT OF RICHARD M. BRESSLER

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

BURLINGTON NORTHERN INC.

My name is Richard M. Bressler. I am Chairman and Chief Executive Officer of Burlington Northern Inc.

I am appearing today at the request of Senator Baucus to discuss the formation of Burlington Northern's holding company, and what it means for the future of the Burlington Northern Railroad.

There are two basic reasons why we formed the holding company. First of all, we wanted to give all of our businesses a chance to develop to their fullest potential. In order to do that, the management of each of our companies, including the railroad, needed to devote full attention to its own business. Our natural resources and land holdings have always been managed separately from the railroad. But we lacked a clearly defined corporate structure for each part of our business. Because of that, some of our managers had to divert their attention from their primary business into other areas where their level of expertise was not as great.

Our new structure makes our managers more effective. The creation of separate operating companies also makes it easier to attract the best executives in specialized fields such as oil exploration and timber management.

There's another good reason for the formation of our holding company. It allows Burlington Northern access to the capital markets in order to support the growth of all our operations. Formerly, as a railroad corporation, we were only permitted by law to issue securities for transportation purposes. This meant that if we wanted to develop other parts of our business, we had to use internally generated funds of the company, most of which came from railroad operations. So instead of threatening to divert funds from railroad operations, the new structure allows us to raise money independently of the railroad for development of our other properties.

Fortunately, we are not faced with an "either/or" situation in the development of our railroad and our natural resource properties. We intend to develop both vigorously, and the holding company structure is the best means to reach this goal.

Some have expressed the fear that the formation of a holding company will mean a downgrading in the importance and financial resources of the Burlington Northern Railroad. Nothing could be further from the truth. Last year, the railroad provided nearly 75 percent of Burlington Northern's operating income, up from 66 percent the year before. The Burlington Northern Railroad is the crown jewel of our corporate family and we are very proud of it.

Because we believe that the Burlington Northern Railroad has a good future, we continue to invest heavily in it. Over the past three years, we have spent over $1.4 billion on maintaining and improving the railroad's track structure. Our 1981 expenses in this category were up 18 percent over 1980. Economic conditions permitting, we plan to increase spending on our track structure significantly again in 1982. At this time, we are not investing heavily in additional freight cars and locomotives because we currently have over 27,000 cars and over 460 locomotives stored and standing idle.

I would like to share with you our strategy for the future of our railroad. While we are pleased with the accomplishments to date, we are still not satisfied. We intend to make the Burlington Northern Railroad one of the most efficient carriers in the industry. To achieve this goal and to insure our financial health and stability, we will continue our efforts to improve productivity and to increase operating efficiency.

Part of this strategy involves increasing our investment in highly efficient track maintenance machines. Our expenditure for this type of equipment will more than triple in 1982 compared with 1981.

Other productivity improvements will require a further trimming of our labor force. Of course, no one likes to lay off people. But we are all familiar with basic industries such as steel and automobiles that have not been very successful in improving their productivity over the years. There is no security in holding a job with a declining company in a declining industry. All of our management efforts are directed toward the goal of keeping the Burlington Northern Railroad a company which is growing in traffic volume and profitability. This, we believe, is the best way to preserve jobs in the long run.

Before I leave the subject of our plans for the railroad, Senator Baucus, I would like to quote from a newsletter that you sent to your constituents last December:

> "We must all be prepared to acknowlege that Burlington Northern is entitled to make a reasonable profit. But we must be just as ready to assert that BN has a substantial obligation to serve the public as well."

Senator Baucus, I agree with you. Fortunately, these two goals are compatible. There are some who would say that "service to the public" means maintaining every branchline that was constructed in the 1800's to serve the transportation needs of that era. I disagree. I think the public is not well served if the railroad is forced to maintain money-losing operations for a small handful of shippers at the expense of the vast majority of our customers.

Last summer, the railroad announced plans to ask the Interstate Commerce Commission for permission to cease operations on 347 miles of branchlines in Montana. Some of these lines have not seen any traffic at all for over five years. One of the lines, over 77 miles in length, has been generating only about 3 cars per week of traffic.

In total, all of these lines account for only about 3 percent of the grain traffic we originate for shippers in Montana. Why should our losses in serving this 3 percent be allowed to drain the resources of the company away from serving the other 97 percent of our customers? That would amount to a disservice to the public in my opinion.

The railroad also announced plans to study the future of an additional 150 miles of trackage in Montana. Last November, the decision was made to definitely retain over half of those miles. Our railroad people are continuing to work with state officials and interested shippers concerning the future of the remaining trackage.

In your letter inviting me to appear at this hearing, Senator Baucus, you asked a number of very detailed historical questions. Those which I am not covering in this statement you will find answered in the attached appendix. I do want to say just a few words about the Northern Pacific mortgage bonds. These bonds are secured by mortgages which encumber all of the former Northern Pacific land grant properties still owned by the Burlington Northern Railroad. While the mortgages do permit sale of these properties, the proceeds from any such sale must be deposited with the mortgage trustee and cannot be withdrawn by the Railroad until it has shown that physical improvements of equal value have been made to the former Northern Pacific rail lines now owned by Burlington Northern.

Over the years, the value of improvements to these rail properties has greatly exceeded our resource earnings. It is not expected that the cumulative value of the resource earnings will catch up to the value of railroad improvements for many years, Burlington Northern is not attempting to retire these bonds or alter the indentures in any way.

The questions you have raised, Senator, concerning transfer of assets from the Railroad to the other operating companies are discussed in the appendix to this testimony. Briefly, the vast majority of the assets will remain with the railroad. The railroad has entered into management agreements with the holding company and with the four resource companies within the BN corporate family - BN Timberlands Inc., Glacier Park Company, Meridian Land & Mineral Company, and Milestone Petroleum Inc. Under these agreements, those companies will manage the railroad's oil and gas, coal and other minerals, timberland, agricultural and real estate development properties.

It would be wrong for anyone to attach any great significance to whether the assets are actually transferred from the railroad to the other companies or simply managed by those companies. Our natural resource and land holdings have always been managed separately from the railroad.

Also, there never was a direct flow of cash from the resource properties to the railroad operations. All of the earnings from all of our businesses always flowed to the corporate level prior to the formation of the holding company. At that point, decisions were made as to budgets and allocation of capital. That same process continues today.

Much has been made over the fact that most of the land which Burlington Northern owns was part of a so-called land grant made by the Federal government to the Northern Pacific Railroad back in the 19th century. Unfortunately, the term "land grant" does not describe what Congress did back in 1864, but I suppose it is now a permanent part of the language.

What actually happened was that Congress, through legislation, made an offer to the Northern Pacific. The Federal government would provide a specified amount of land if the Northern Pacific, in return, would assume the very substantial risk of investing its capital in the construction of transcontinental main line across an undeveloped wilderness. Both sides performed their part of the contract, and title to the land passed to the railroad.

Furthermore, Northern Pacific was required to transport government freight, military personnel and mail at greatly reduced rates well into the next century. By the time the reduced rates were eliminated by the Congress in 1945, the value of the land had been repaid many times.

It was never intended by Congress that the land provide any continuing operating subsidy. In fact, Congress permitted most of the land to be sold for its original purpose - raising capital to spend on railroad construction.

The situation is similar in many ways to that of the original homesteaders in the West. That land was given to stimulate the development of homes and farms. Today, much of that land is used for other purposes.

Incidentally, other forms of transportation were treated very differently. There has never been any attempt to charge highway users for the land used to build highways nor have the historical costs involved in building the inland waterway system ever been recovered.

You will hear some people say that the land really has not been paid for because it is worth much more today than it was when it was originally conveyed back in the 19th century. We do not deny that the land is worth more today that it was 100 years ago. But that line of reasoning would suggest that all of us who own homes or farms should go back to the person from whom we purchased them and pay additional money because those properties are now worth more than they were when we originally bought them. Obviously, that makes no sense.

One of the concerns that has been expressed about Burlington Northern's plans for the future relates to our continued investment in the railroad compared with our other businesses. Many of our other companies are relatively young and small. Therefore, we expect them to grow at a faster rate than the railroad does and gradually produce a larger share of our total income. However, we do expect the railroad to continue growing.

Some people, looking at the historical rates of return that our various businesses have earned, have noticed that the railroad is the lowest. They have then concluded that we naturally would not want to invest much money in such an enterprise. This is a neat little piece of logic which is totally wrong.

Business managers do not make decisions based on historical rates of return. We do not invest our capital today based on what past investments have earned. Rather, we look at the potential for future earnings from the money we are investing today. There are many investments in our railroad that earn a rate of return as high or higher than other investment opportunities we have. One, which I mentioned earlier, is the purchase of additional mechanized track maintenance equipment. There are numerous other investments that improve the productivity and efficiency of our railroad operations and offer a very high rate of return.

The increasing amounts which we are spending on the railroad's physical plant are being budgeted on the basis of the returns we expect to earn. Put simply, the Burlington Northern Railroad is doing a very good job of competing for capital within our company, and we expect that it will continue to do so.

Senator, you asked specifically about the decline in Burlington Northern's capital expenditures from 1980-81. Actually, our capital expenses for the track structure -- our real investment in the future -- increased during that time by more than $25 million. What declined was investment in new freight cars and locomotives. The reason was very simple -- during 1981 we had large surpluses of rolling stock...surpluses which continue today.

Up to this point, I have talked exclusively about our railroad operations. Two of our other companies have their headquarters in Montana and the presidents of those companies are with me today. Bruce Ennis, from Billings, is President of Meridian Land & Minerals, our mineral development company. He and his growing staff are working on the development of our coal and mineral properties in Montana and throughout our system.

Fred Winegar, of Columbia Falls, Montana, is President of Plum Creek, our forest products manufacturing company. We are very proud of the fact that Plum Creek has consistently maintained a higher level of production and employment than many other companies in its industry during some very difficult times. Plum Creek is still running all facilities except logging operations and is providing jobs to over 1100 Montanans. Fred is running his business at close to 75% of capacity, compared with less than 60% for the industry.

Both of these gentlemen would be happy to answer any questions you might have about their companies.

We have also been very active in attempting to develop new international markets for coal, grain and forest products. Also with me today is Mr. Ted Michon, our Vice President-International, who is a regular commuter to the Far East and is in the process of developing some very significant export markets, many of which will directly benefit Montana.

In closing, I would like to say that it is the policy of Burlington Northern and all of our operating companies to take seriously our responsibilities to the public. Our foremost responsibility is to operate a growing and profitable business. Without that, nothing else is possible.

In the process of achieving that goal, we believe in cooperating with public officials at every level. A good example of this cooperation between business and government has been the work Ted Michon has done on developing new coal and grain export business through the Port of Astoria, Oregon. Senator Hatfield traveled to Korea in support of this project and was extremely helpful in bringing it about. This new movement of corn and wheat will amount to more than 120 million bushels per year by the mid-1980s, and we expect that Montana producers will be in a good position to compete in this major new export market.

Another example would be the work that our railroad people have done with state officials in North Dakota to develop a major branchline rehabilitation program in that state. Also, just last week Governor Schwinden announced a Burlington Northern branchline rehabilitation project in Montana, developed jointly by state officials and our railroad people.

Fortunately, such cooperation is made easier by the fact that our objective is really the same as yours - a healthy and growing Montana. In achieving this goal, one of the best assets that Montana and the rest of our service territory can have is a strong rail system. All of the hearings, studies, articles, speeches and court cases in the world will not change one basic fact...if Montana is a good place to be in the railroad business -- and we think it is -- then the Burlington Northern Railroad will be there for the long haul.

APPENDIX

TO

STATEMENT OF RICHARD M. BRESSLER

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

BURLINGTON NORTHERN INC.

BEFORE THE

AGENCY ADMINISTRATION SUBCOMMITTEE

OF THE

SENATE JUDICIARY COMMITTEE

WASHINGTON, D.C.

MARCH 26, 1982

I. Transfer of Railroad Assets

The Railroad has entered into management agreements with the Holding Company and with the four resources companies within the BN corporate family - BN Timberlands Inc., Glacier Park Company, Meridian Land & Mineral Company and Milestone Petroleum Inc. Under these agreements the resources companies manage the Railroad's and its affiliates' oil and gas, coal and other minerals, timberland, and agricultural and real estate development properties.

The agreements implement one of the central purposes of BN's corporate restructuring: to permit the Railroad's top management to concentrate on running the Railroad in the most effective manner possible, unencumbered by the necessity of also managing the natural resources, which really requires different skills and business experience. At the same time, these agreements provide a vehicle for attracting new and highly skilled managers to develop and manage our non-transportation businesses and resources effectively.

To implement the management agreements the Railroad has also transferred accounts receivable and payable relating to these businesses to the four resources companies. However, all moneys from the Northern Pacific land grant properties required to be deposited with the Trustees of the NP mortgages are being deposited on behalf of the Railroad. The Railroad then draws down this cash through certificates of additions and betterments more generally referred to in the statement. Starting on January 1, 1982 the Railroad has been declaring monthly dividends in amounts equal to the net proceeds from its natural resource properties.

On December 31, 1981 the Railroad made cash capital contributions of $10 million to Glacier Park, $4 million to Meridian, and $50 Million to Milestone. These are funds necessary for the growth and development of BN's natural resources. The figures reflect what the Railroad, prior to our reorganization, would have expended to achieve the same levels of development of its lands and minerals.

As part of the redeployment of assets into different business units within our corporate family the Railroad has contributed to Milestone its 10 percent interest in Butte Pipe Line Company and its 50 percent interest in Portal Pipe Line Company. Since January 1, 1982 the Railroad has transferred to the Holding Company its 50 percent interest in New

Mexico and Arizona Land company, and all of the capital stock of several wholly-owned subsidiaries - Burlington Northern Air Freight Inc., Plum Creek Inc., Glacier Park Company, and BNL Development Corporation (including the stock in several small companies owned by Glacier Park and Plum Creek).

II. Merger Matters Other Than Northern Lines Merger

A. Rail Merger Policies and Procedures of Interstate Commerce Commission

Burlington Northern agrees with the Interstate Commerce Commission's announced General Policy of encouraging private industry initiative to rationalize the nation's rail facilities and reduce its excess capacity. We regard as rational the Commission's balancing test of weighing potential benefits to applicants and the public against potential harm to the public, in deciding merger and acquisition of control cases.

The Commission's General Policy Statement identifies two potential harms to the public to be considered: harm to competition and harm to essential services. Although the agency has generally narrowed the bases on which it will attach conditions to approval of a merger or control transaction, it has indicated that it will impose conditions on a proper showing of either harm. The anticompetitive circumstances attending the proposed Union Pacific/Missouri

Pacific/Western Pacific control case, discussed below, necessitate conditions, not to protect Burlington Northern traffic, but to preserve competition for coal traffic in the Powder River Basin of Wyoming. The Commission itself created such competition by approving transactions enabling Union Pacific and Chicago and North Western Transportation Company to compete with BNRR for this business.

In the Staggers Rail Act of 1980 Congress amended the 4-R Act with respect to merger procedures and again mandated the expedited handling of these cases. We fully agree with the necessity of moving such proceedings to a reasonably rapid conclusion, and the 2 1/2-year limit fixed by Congress for a final ICC decision in major rail merger cases is reasonable. BN does not otherwise take issue with the procedures for merger cases established by Congress and the Commission.

B. BN-Frisco Merger

The BN-Frisco merger approved by the ICC and effective November 21, 1980 was clearly in the public interest. The merger of these two end-to-end carriers yielded substantial service improvements and efficiencies in 1981, the first full year of operations of the new system. Single-carrier service between the former Frisco territory and the Midwest and Pacific Northwest provides shippers with far more efficient access to markets and Gulf ports served by the merged lines.

Operations of the combined systems have been marked by high speed through trains. To cite just one example, the Railroad now provides fifth morning delivery on service between Portland, Oregon and Birmingham, Alabama, a distance of 2,974 miles. In the past year we have pruned 102 miles off the Portland to Birmingham operation and have cut running time by 13 1/2 hours. We have established similar high speed, single-line service between Denver and Memphis; Minneapolis-St. Paul and Memphis; and from Chicago to Irving, Texas (Dallas-Fort Worth). On March 29 (next Monday) we will inaugurate transcontinental service between Seattle-Portland and Houston over the merged lines. Our scheduled running time of 114 hours from Portland to Houston will be the fastest published rail schedule in the United States between these markets.

In addition, the BN-Frisco merger has (1) enabled the combined roads to eliminate or reduce duplicate facilities and costly intercharges at St. Louis and Kansas City, the principal former junctions between the carriers; (2) materially improved car supply in former Frisco territory; (3) increased locomotive and caboose utilization through centralized fleet management, consolidation of traffic flows and unification of terminal functions at St. Louis and Kansas City; and (4) strengthened competition by enabling BN to offer head-to-head competition with other single-line carriers serving the Midwest, South and Southwest.

We have also benefitted greatly, of course, by the addition to BN's ranks of former Frisco officers, managers and employees.

C. BNRR - Colorado and Southern Merger

The Colorado and Southern Railway Company (C&S) was merged into Burlington Northern Railroad Company effective December 31, 1981. Prior to that time the Railroad owned 92.57% of all outstanding stock in C&S, which was a key component of the unified BN carrier system.

The merger was a step, then, toward corporate simplification. It did not reduce service or change the competitive balance with carriers outside the corporate family. The merger was accomplished pursuant to an ICC exemption and in furtherance of earlier Commission urgings that BN simplify its corporate structure. Benefits achieved include elimination of such functions as record keeping and inter-company accounting, and elimination of the general administrative burden of maintaining the separate corporate existence of C&S.

The Fort Worth and Denver Railway Company, formerly a subsidiary of C&S, is now a wholly-owned subsidiary of Burlington Northern Railroad Company and remains an integral part of the BN rail system.

D. Burlington Northern's Concerns About the Proposed UP/MoPac/WP Unification

BNRR does not oppose control by Union Pacific of the Missouri Pacific Railroad Company and Western Pacific Railroad Company, so long as the ICC prescribes conditions which will permit maintenance of competitive rail service for the transportation of western coal. This proposed unification will give UP access - in many cases exclusively - to far more coal producing areas throughout the West, Midwest and Southwest than any other carrier.* In addition, control of Missouri Pacific will provide UP with direct access to the many major coal destinations served exclusively by MoPac in Texas, Arkansas, Oklahoma and Louisiana, thereby destroying MoPac's independence as a neutral connection for carriers which compete with Union Pacific for the transportation of coal. The Commission has held that there can be no competition where an unaffiliated origin carrier does not have independent access to a power plant, but must instead rely on a competing origin carrier (or a carrier controlled thereby) to reach the destination.

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*Principal origins served by UP today include areas in Utah, Colorado and southern Wyoming. MoPac today serves coal producing areas in Illinois, Missouri, Oklahoma and Texas. In addition, Rocky Mountain Energy Company, a wholly-owned subsidiary of the parent Union Pacific Corporation, is a substantial owner and producer of coal which is moved via UPRR.

Similarly, by virtue of the proposed unification, UP would obtain access to a broad array of potential coal export facilities, including most major ports on the West Coast, Gulf Coast and Mississippi River, which, taken together with UP's prospective and unparalleled access to producing areas, can only have a substantially dampening effect on potential competition in coal export markets.

Far more insidious in its anticompetitive effect, however, is the cumulative impact of the so-called Connector Line transactions and the proposed UP/MoPac consolidation. BNRR has historically been the sole railroad serving the Powder River Basin and the Powder River Basin has, in turn, become the most attractive and important source of low sulphur western coal. The Connector Line transactions involve a number of joint CNW/UP projects which were approved by the Commission to enable these lines to compete with BNRR for the transportation of Powder River Basin coal. The competition thereby created by the Commission would be eradicated by the proposed unification, and BNRR would be eliminated as a competitor to Union Pacific for all Powder River Basin coal moving to Missouri Pacific destinations.

Because of coal, therefore, the competitive ramifications of a UP/MoPac unification are radically different from those attending the BN-Frisco merger. Coal is unique - major markets in the South Central U.S., i.e., several public utilities, burn only Powder River Basin coal. Unlike the usual situation with other, general commodities, there are no dispersed sources of supply served by a number of carriers. And unlike the former Frisco, which delivered very little coal, MoPac dominates the South Central market as the sole rail carrier serving many of these large public utilities. BN does not oppose end-to-end mergers, but a UP/MoPac unification without conditions relating to coal would enable these lines to wipe out competition for this traffic.

Accordingly, in the application proceedings for UP control of MoPac and WP, BNRR has proposed conditions which would accord BNRR (1) trackage rights to five coal-fired plants now served exclusively by Missouri Pacific, and (2) independent ratemaking authority permitting BNRR to establish, without MoPac concurrence, joint rates with MoPac on coal moving from BNRR points to Missouri Pacific destinations, with divisions based on a variable cost prorate of revenues.* These conditions will not guarantee to BNRR any coal out of the Powder River Basin. They will operate only to preserve price and service competition, with the traffic going to the most efficient operator.

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*We have not discussed here two other proposed conditions which do not bear specifically on the Subcommittee's inquiry. Their omission in this presentation does not mean we consider the matters unimportant in the ICC proceedings.

E. Northern Lines Merger

A full account of all benefits resulting from the Northern Lines merger would require a complete review of the entire BN system, a project not achievable in the limited time available before the March 26 hearing. The record of the 1970's demonstrates, however, that the Great Northern, Northern Pacific, CB&Q and SP&S as separate entities could not conceivably have made the contributions to the public interest which BN has achieved.

First of course have been the substantial improvements and other operating changes necessary to utilize the particular advantages of each predecessor carrier. Line changes at Casselton, North Dakota, Sandpoint, Idaho and in Spokane were necessary to form BN's high-speed transcontinental main line and otherwise link together track of the predecessor roads for shorter hauls, lower grades and other efficiencies. The Latah Creek project at Spokane alone linked the former lines of the GN, NP and SP&S and required construction of 11 bridges and seven miles of new railway.

New or improved electronic classification yards at Minneapolis, Kansas City and Pasco, Washington combined with these line changes and other improvements to speed up service dramatically. The Northtown Yard at Minneapolis, a $43 million state-of-the-art facility completed in 1976, replaced 11 separate yards of the GN, NP and CB&Q remaining from pre-merger days. Pre-blocking at Northtown of cars destined for the East alone saves 12 to 24 hours in interchange time at Chicago.

At the time of the Northern Lines case scheduled running time for Great Northern and Northern Pacific's fastest trains from Seattle to Chicago (via the Burlington from Minneapolis-St. Paul) exceeded 94 hours. Today BN's eastbound TOFC train operates on a scheduled run of 67 hours. Our fastest train westbound from Chicago to Seattle operates on a scheduled run of 55 1/3 hours. Similar service improvements have been made elsewhere. For example, running times from former Great Northern points west of Spokane to Kansas City, Omaha and other Missouri-Mississippi Valley points were cut by more than 20 hours by use of the shorter former Northern Pacific route from Spokane to Laurel, Montana, for movement beyond via the former CB&Q.

The three electronic classification yards represent only a small part of the consolidation or improvement of facilities which the Commission envisioned in approving the Northern Lines merger and which BN has carried out. Excess flat switching yards at Spokane and Wishram, Washington and at Savannah, Illinois were no longer needed and were closed.

Locomotive repair and overhaul work performed by Great Northern before merger at St. Paul shifted to the former Northern Pacific shop at Livingston, Montana and to the former CB&Q shop at West Burlington, Iowa. Northern Pacific's car shop at Brainerd was closed, and the work shifted to our Havelock shop near Lincoln, Nebraska (on the former CB&Q) and to the former Great Northern shop at St. Cloud, Minnesota. An automated wheel shop at Havelock permitted elimination of similar facilities at five other locations. These are just a few examples of a massive systemwide shift toward greater efficiency.

Such consolidations have been accompanied by our enormous investments in coal lines and equipment, and in coal support facilities; expansion systemwide of the former Northern Pacific microwave communications system; installation of a sophisticated, computerized locomotive and car information system; replacement of obsolescent bridges; and steady progress in other programs such as expanded use of continuous welded rail and centralized traffic control.

These advances, most of them contemplated by the Commission in the Northern Lines case, and the concentration of traffic on a single railroad, have yielded substantial improvements in efficiencies, as shown by the following table:

Freight Train Averages	1971	1976	1981
Train load revenue net tons	1,653	2,275	2,786
Gross ton-miles per train hour	76,000	103,000	123,000
Net ton-miles per car day	1,474	2,105	3,116
Net tons per carload	47.7	59.6	68.2

It is impossible to put a price tag on net savings resulting from the Northern Lines merger. BN undertook to measure savings after merger but the task proved so difficult it was abandoned after a year or two.

Obviously the unit improvements cited above resulted in part from increased traffic volume. A number of external economic factors contributed to this increase, including sharply rising demand for western coal, accentuated by energy crises of the past decade; growing world markets for grain; and increasing imports of autos and other manufactured goods from Japan. The decline and ultimate demise of the Milwaukee Road in the latter 1970's in the Pacific Northwest left some traffic open to diversion, but BN was and is subject to intensive competition from other carriers, including Union Pacific, the two transcontinental Canadian rail lines and highway operators. Increased traffic volume has contributed to BN's greater efficiency, but this was achievable only because BN, following the Northern Lines case, built a productive system consistent with stated merger objectives and capable of responding to shipping needs.

Burlington Northern firmly believes that it fully executed the Milwaukee protective conditions prescribed in the Northern Lines case. We are aware of no evidence to the contrary. Prescribed trackage rights were granted, including access to Portland and Billings, the 11 western gateways were opened, and all other requirements complied with.

Mr. **Bressler**. We hope to try to clarify some of the misconceptions and misunderstandings with respect to the formation of our holding company. There are two basic reasons why we formed the holding company. First of all, we wanted to give all of our businesses a chance to develop to their fullest potential. In order to do that, the management of each of our companies, including the railroad, needed to devote full attention to its own business. Our natural resources and land holdings have always been managed separately from the railroad. But we lacked a clearly defined corporate structure for each of our businesses. Because of that, some of our managers had to divert their attention from their primary business into other areas where their level of expertise was not as great.

Our new structure makes our managers more effective. The creation of separate operating companies also makes it easier to attract the best executives in specialized fields such as oil exploration and timber management.

There is another good reason for the formation of our holding company. It allows Burlington Northern access to the capital markets in order to support the growth of all of our operations. Formerly, as a railroad corporation, we were only permitted by law to issue securities for transportation purposes. This meant that, if we wanted to develop other parts of our business, we had to use internally generated funds of the company, most of which came from railroad operations. And we believe that is the case, despite some of the testimony so far this morning.

So, instead of threatening to divert funds from railroad operations, the new structure allows us to raise money independently of the railroad for development of our other properties.

Fortunately, we are not faced with an either/or situation in the development of our railroad and our natural resource properties. We intend to develop both vigorously, and the holding company structure is the best means to reach this goal.

Some have expressed the fear that the formation of a holding company will mean a downgrading of the importance and financial resources of the Burlington Northern Railroad. Nothing could be further from the truth. Last year, the railroad provided nearly 75 percent of Burlington Northern's operating income, up from 66 percent the year before. The Burlington Northern Railroad is the crown jewel—I will repeat that—is the crown jewel of our corporate family, and we are very proud of it.

Because we believe that the Burlington Northern Railroad has a good future, we continue to invest heavily in it. Over the past 3 years, we have spent over $1.4 billion on maintaining and improving the railroad's track structure. Our 1981 expenses in this category were up 18 percent over 1980. Economic conditions permitting, we plan to increase spending on our track structure significantly again in 1982. At this time, we are not investing heavily in additional freight cars and locomotives because we currently have over 27,000 cars and over 460 locomotives stored and standing idle.

I would like to share with you our strategy for the future of our railroad. While we are pleased with the accomplishments to date, we are still not satisfied. We intend to make the Burlington Northern Railroad one of the most efficient carriers in the industry. To achieve this goal and to insure our financial health and stability, we will continue our efforts to improve productivity and to increase operating efficiency.

Part of this strategy involves increasing our investment in highly efficient track maintenance machines. Our expenditure for this type of equipment will more than triple in 1982 compared with 1981.

Other productivity improvements may require a further trimming of our labor force. No one likes to lay off people. We are all familiar with basic industries such as steel and automobiles that have not been very successful in improving their productivity over the years. There is no security in holding a job with a declining company in a declining industry. All of our management efforts are directed toward the goal of keeping the Burlington Northern Railroad a company which is growing in traffic volume and profitability. This, we believe, is the best way to preserve jobs in the long run.

Mr. Grayson gave me some statistics this morning on railroad employment in the State of Montana over the years, and I thought it might be interesting. In 1977 we employed 6,181 people. In 1981 it was 6,563. There is somewhat of an increase over that period of time.

Before I leave the subject of our plans for the railroad, I would like to quote from a newsletter that you sent to your constituents last December:

> We must all be prepared to acknowledge that Burlington Northern is entitled to make a reasonable profit. But we must be just as ready to assert that BN has a substantial obligation to serve the public as well.

Senator Baucus, I agree with you. Fortunately, these two goals are compatible. There are some who would say that service to the public means maintaining every branchline that was constructed in the 1800's to serve the transportation needs of that era. I disagree with that. I think the public is not well served if the railroad is forced to maintain money-losing operations for a small handful of shippers at the expense of the vast majority of our customers.

Last summer, the railroad announced plans to ask the Interstate Commerce Commission for permission to cease operations on 347 miles of branchlines in Montana. Some of these lines have not seen any traffic at all for over 5 years. One of the lines, over 77 miles in length, has been generating only about 3 cars per week of traffic.

In total, all of these lines account for only about 3 percent of the grain traffic we originate for shippers in Montana. Why should our losses in serving this 3 percent be allowed to drain the resources of the company away from serving the other 97 percent of our customers? That would amount to a disservice to the public.

The railroad also announced plans to study the future of an additional 150 miles of trackage in Montana. Last November, the decision was made to definitely retain over half of those miles. Our railroad people are continuing to work with State officials and interested shippers concerning the future of the remaining trackage.

In your letter inviting me to appear at this hearing, you asked a number of very detailed historical questions. Those which I am not covering in this statement you will find answered in the attached appendix. I do want to say just a few words about the Northern Pacific mortgage bonds. These bonds are secured by mortgages which encumber all of the former Northern Pacific land-grant properties still owned by the Burlington Northern Railroad. While the mortgages do permit sale of these properties, the proceeds from any such sale must be deposited with the mortgage trustee and cannot be withdrawn by the railroad until it has shown that physical improvements of equal value have been made to the former Northern Pacific rail lines now owned by Burlington Northern.

Over the years, the value of improvements to these rail properties has greatly exceeded our resource earnings. It is not expected that the cumulative value of the resource earnings will catch up to the value of railroad improvements for many years, speculation notwithstanding. Burlington Northern is not attempting to retire these bonds or alter the indentures in any way.

The questions you have raised, Senator, concerning transfer of assets from the railroad to the other operating companies are discussed in the appendix to this testimony. Briefly, the vast majority of the assets will remain with the railroad. The railroad has entered into management agreements with the holding company and with the four resource companies within the BN corporate family: BN Timberlands, Inc., Glacier Park Co., Meridian Land & Mineral Co., and Milestone Petroleum, Inc. Under these agreements, those companies will manage the railroad's oil and gas, coal, and other minerals, timberland, agricultural, and real estate development properties.

It would be wrong for anyone to attach any great significance to whether the assets are actually transferred from the railroad to the other companies or simply managed by those companies. Our natural resource and land holdings have always been managed separately from the railroad.

Also, there never was a direct flow of cash from the resource properties to the railroad operations. All of the earnings from all of our businesses always flowed to the corporate level prior to the formation of the holding company. At that point, decisions were made as to budgets and allocation of capital. That same process continues today.

Much has been made over the fact that most of the land which Burlington Northern owns was part of a so-called land grant made by the Federal Government to the Northern Pacific Railroad back in the 19th century. Unfortunately, the term "land grant" does not describe what Congress did back in 1864, but I suppose it is now a permanent part of the language.

What actually happened was that Congress, through legislation, made an offer to the Northern Pacific. The Federal Government would provide a specified amount of land if the Northern Pacific in return would assume the very substantial risk of investing its capital in the construction of transcontinental main line across an undeveloped wilderness. Both sides performed their part of the contract, and title to the land passed to the railroad.

Furthermore, Northern Pacific was required to transport Government freight, military personnel, and mail at greatly reduced rates well into the next century. By the time the reduced rates were eliminated by the Congress in 1945, the value of the land had been repaid many times.

It was never intended by Congress that the land provide any continuing operating subsidy. In fact, Congress permitted most of the land to be sold for its original purpose: raising capital to spend on railroad construction.

The situation is similar in many ways to that of the original homesteaders in the West. That land was given to stimulate the development of homes and farms. Today much of that land is used for other purposes.

Incidentally, other forms of transportation were treated very differently. There has never been any attempt to charge highway users for the land used to build highways nor have the historical costs involved in building the inland waterway system ever been recovered.

You will hear some people say that the land really has not been paid for because it is worth much more today than it was when it was originally conveyed back in the 19th century. We do not deny that the land is worth more today than it was 100 years ago. But that line of reasoning would suggest that all of us who own homes or farms should go back to the person from whom we purchased them and pay additional money because those properties are now worth more than they were when we originally bought them. Obviously, we do not think that makes any sense.

One of the concerns that has been expressed about Burlington Northern's plans for the future relates to our continued investment in the railroad compared with our other businesses. Many of our other companies are relatively young and small. Therefore, we expect them to grow at a faster rate than the railroad does and gradually produce a larger share of our total income. However, we do expect the railroad to continue growing.

Some people, looking at the historical rates of return that our various businesses have earned, have noticed that the railroad is the lowest. They have then concluded that we naturally would not want to invest much money in such an enterprise. This is a neat piece of logic which is totally wrong.

Business managers do not make decisions based on historical rates of return. We do not invest our capital today based on what past investments have earned. Rather, we look at the potential for future earnings from the money we are investing today. There are many investments in our railroad that earn a rate of return as high or higher than other investment opportunities we have. One, which I mentioned earlier, is the purchase of additional mechanized track maintenance equipment. There are numerous other investments that improve the productivity and efficiency of our railroad operations and offer a very high rate of return.

The increasing amounts which we are spending on the railroad's physical plant are being budgeted on the basis of the returns we expect to earn. Put simply, the Burlington Northern Railroad is doing a very good job of competing for capital within our company, and we expect that it will continue to do so.

You asked specifically about the decline in Burlington Northern's capital expenditures from 1980 to 1981. Actually, our capital expenses for the track structure, our real investment in the future, increased during that time by more than $25 million. What declined was investment in new freight cars and locomotives. The reason was very simple. During 1981 we had large supluses of rolling stock, surpluses which continue today, unfortunately.

Up to this point, I have talked exclusively about our railroad operations. Two of our other companies have their headquarters in Montana and the presidents of those companies are with us. I previously introduced them.

In the case of Plum Creek, we are proud of the fact that Plum Creek has consistently maintained a higher level of production and employment than many other companies in its industry during some very difficult times. Plum Creek is still running all facilities except logging operations and is providing jobs to over 1,100 Montanans. Fred Winegar is running his business at close to 75 percent of capacity, compared with less than 60 percent for the rest of the industry.

Both Fred Winegar and Bruce Ennis, I am sure, would be happy to answer any questions you have about their companies.

We have also been very active in attempting to develop new international markets for coal, grain, and forest products. Also with me today at the end of the table is Ted Michon, our vice president—international, who is a regular commuter to the Far East and is in the process of developing some very significant export markets, many of which will benefit Montana.

In closing, I would like to say that it is the policy of Burlington Northern and all of our operating companies to take seriously our responsibilities to the public. Our foremost responsibility is to operate a growing and profitable business. Without that, nothing else is possible.

In the process of achieving that goal, we believe in cooperating with public officials at every level. A good example of this cooperation between business and government has been the work Ted Michon has done on developing new coal and grain export business through the Port of Astoria, Oreg. Senator Hatfield traveled to Korea in support of this project and was extremely helpful in bringing it about. This new movement of corn and wheat will amount to more than 120 million bushels per year by the mid-eighties, and we expect that Montana producers will be in a good position to compete in this major new export market.

Another example would be the work that our railroad people have done with State officials in North Dakota to develop a major branchline rehabilitation program in that State. Just last week Governor Schwinden announced a Burlington Northern branchline rehabilitation project in Montana, developed jointly by State officials and our railroad people.

Fortunately, such cooperation is made easier by the fact that our objective is really the same as yours, a healthy and growing Montana. In achieving this goal, one of the best assets that Montana and the rest of our service territory can have is a strong rail system. All of the hearings, studies, articles, speeches, and court cases in the world will not change one basic fact: if Montana is a good place for us to be in the railroad business—and we think it is—then the Burlington Northern Railroad will be there for the long haul. Thank you.

Senator BAUCUS. Thank you very much.

I understand that Mr. Martin wants to make a statement at this point.

Mr. MARTIN. Thank you, Senator. I can condense my remarks, I think, fairly well under the circumstances.

I would like to address myself to just one main question and one not minor question but secondary to my discussion. I would like to address myself to the proposition that it was the formation of the Chicago Milwaukee St. Paul Holding Co. in 1970 which contributed either solely or definitively and determinatively to the collapse of the Milwaukee Road. Second, I would like to address myself briefly to the question of whether or not the Burlington Northern merger itself of 1970 did in fact contribute to the Milwaukee's distress.

I do this in a historical fashion because history, after all, is the accumulation of events over a long period of years which subsequently constitute trends that have to be dealt with if a thorough understanding is to be had.

The seeds of the Milwaukee Railroad collapse were planted as early as the first years of the 1880's. That was the most fateful decade in the development of western railroads systems. Since that time, even at the height of an enviable prosperity and apparent success, decisions both made and not made were continuing to seal the ultimate doom of this railroad as a viable independent carrier. The Milwaukee's fatal weakness over these years lay in those executives who formulated and put into effect strategic decisions. These men were, for the most part, only part-time executives, being directors rather than full-time professional managers, and men of great wealth and a variety of other interests. The Milwaukee had to compete for their time and attention, which was not always forthcoming and was frequently incompetent.

The Milwaukee was one of several large granger railroads, as they were called, that were quickly and inexpensively built through the States of the Midwest, primarily Illinois, Wisconsin, Missouri, Iowa, and Minnesota, in the years following the Civil War, as these rich lands quickly filled up with settlers. The word granger merely means farmer, and these were indeed farmers' railroads. Their chief function was that of gathering up the harvest and transporting it to one of the gateway cities, chiefly Chicago and St. Louis, where the trunklines, New York Central, Pennsylvania, et cetera, would take it east to the large volume domestic market or to the docks for export to Europe, and to distribute to these same midwestern farmers the manufactured goods of the East, on which western farmers seemed to grow more dependent with each passing year.

Each of the granger roads prospered in a lucrative carrying trade based largely upon serving numerous points on an exclusive basis and in carrying freight which was either short haul or originated or terminated at points served exclusively by a single line. This was the age of total ascendance by the railroad. No one went anywhere or shipped anything more than a few miles without using the railroad.

The leading granger roads were the Milwaukee, or the St. Paul as it was colloquially called in the days before the reorganization of the late twenties, the Burlington, the Rock Island, and the Northwestern. It is vital to note that of these roads one is defunct, the Rock Island; one, the Northwestern, as I understand it, has been sold to its employees and will sooner or later be a problem for policymakers unless the benefits of deregulation are speeded up; one, the Milwaukee, is in bankruptcy and withering away at its western extremities; and one, the Burlington, is the heart and bulwark of one of the most successful and progressive integrated railroad systems in the country. It is no accident that only the Burlington made a timely decision as to a transcontinental connection before the inflation of the pre-World War I decades removed it as a practical possibility.

Beginning with the return of prosperity in 1879, following the very serious industrial depression of 1873 to 1878, the character of midwestern railroading began to change, at first slowly and then with increasing speed. By 1885 there were five completed transcontinental railroads, depending on how you define transcontinental: The Union Pacific-Central Pacific or overland route, the first transcontinental; C. P. Huntington's Southern Pacific, with its terminal at New Orleans; the Union Pacific's branch, the Oregon Short Line, that made it a through route from Omaha to Portland, Oreg.; the Santa Fe; and the Northern Pacific. In 1893 the Great Northern was opened and George Gould, having inherited his father's southwestern lines, was expected sooner or later to extend the Missouri Pacific and Rio Grande roads to San Francisco, as he did through the medium of the Western Pacific.

As a result of this hectic railroad development, which in the 1880's added several times as much route mileage to American railroads as had existed in total at the time of the Civil War, long-haul or through business began to dominate traffic. Since only the Santa Fe had its own rails all the way into Chicago, the granger roads had the opportunity to carry most of this freight for several hundred miles on the eastern end. Transcontinental traffic was made feasible by low through rates. It has often been said that the West was built on low long-distance railroad freight rates. The great question was, How were these through rates, which worked out to a fraction of the short-haul rates on a per mile basis, to be divided between the carriers in these end-to-end systems? Where several carriers formed an end-to-end alliance of independent roads, the divisions were the result of sheer bargaining strength, and rates fluctuated violently without notice.

It was no basis for orderly business operations. Accordingly, one of the granger lines swallowed its pride of independence and tied up with its partners, on the theory that in business, as in life, a legal marriage is better than a common law arrangement.

I am referring, of course, to the Burlington, which, through the sagacity of its president, Charles Perkins, and the Boston capitalists who had built it up in the 19th century, had formed a cozy relationship with James Hill's Manitoba road in the upper Midwest even before Hill had made the decision to build to the coast. After Hill opened his carefully surveyed, economically built, and efficiently operated extension to Puget Sound, it was only a question of time before the obvious advantages of tying the Burlington and Great Northern knot tighter would be irresistible. The sum total and the point of all of this is that the Burlington did in fact find a home. It did settle for a transcontinental connection which it controlled or which controlled it, depending on how you look at it. It was really quite beside the point because ever since 1901 these three railroads have been operated very harmoniously, in Mr. J. P. Morgan's famous term, as a single unit, notwithstanding the Supreme Court, the Congress, public opinion, et cetera. It was not something that people would explicitly approve, but it sure made them feel good when it came to efficiency.

The period from 1898 to 1920 was one of great prosperity in the United States. To make a long story somewhat shorter, the management of the Milwaukee Road, which was unquestionably the strongest of those roads, were, to put it mildly, very, very unhappy about the fact that they did not possess full control of a transcontinental connection and had to continue to exercise their sheer bargaining power in the division of through rates, which got less sheer and less sheer as time went on.

What happened, of course, was that the operating management of the Milwaukee, several of whose members were members of the board of directors, appeared before the board and said that we can build that extension to the Pacific coast, gentlemen, for $60 million. The Milwaukee board accepted the verbal estimate of the cost of building the Pacific extension as presented by operating management without demanding anything like the exhaustive engineering studies that would be standard procedure today. In other words, the board of directors, which had been in the habit for about 25 years at that point of making very fundamental strategic operating decisions for the railroad, failed to make that one category of decision, which any board of directors has as a final responsibility, which is to say to management: How do you know you can, and where are you going to build it?

The $60 million estimate was based apparently on nothing but the president's opinion. It was exceeded four times over, producing a cost overrun that would be a matter of pride for almost any government supplier today. Meanwhile, several costly acquisitions of useless branchlines had foolishly been made.

Whether the Milwaukee would have recovered from its long-term downward slide after 1920 if no new factors had entered the picture—that is to say, with this expensive, poorly located and terribly burdensome, financewise, extension to the Pacific Coast—it would then have managed at least to stay in the black is a useless question, for the simple reason that in business new factors are always entering the picture. And they entered the railroad picture very rapidly in this period.

The basic profitability of the old Granger lines was destroyed and very largely by Detroit and Washington after the First World War. What the coming of the motor truck did not do to destroy the profitable traffic of most American railroads, regulation as carried out by the Interstate Commerce Commission all but finished it. By the early 1920's, the smart money was being pulled out of the Milwaukee.

World War II and the liquidity that it engendered for the railroads gave them a reprieve, but by 1950 the long-term trends had reasserted themselves. By the mid-1950's nobody in the know believed that the Milwaukee or the North Western or the Rock Island had any future. The ICC, in its role as judge of whether mergers are in the public interest, procrastinated so scandalously as to justify its abolishment on those grounds alone, and the merger route was effectively shut off for most of the old Granger roads when they still had some natural beauty remaining to them.

Whether one chooses 1890 or 1905 or 1928 or 1932 or 1950 as the date by which the ultimate fate of the Milwaukee had been sealed, it seems clear that restructuring the corporation within a holding company after 1970 can have had very little to do with the outcome.

That proposition that it did reminds of a statement that was made by a very high scholar and professor in the field of the training of public school teachers in the United States. When somebody came to him with yet another way of revising the American public school system, he said, "Gentlemen, sometimes I have this terrible feeling that we are merely rearranging the chairs on the deck of the *Titanic*." And that is exactly what the Milwaukee was doing in 1970.

The burning question, of course, is why was the Milwaukee mismanaged, why did they get themselves in a situation like that? What is there about the flow of power and the exercise of property rights, et cetera, that would explain that?

Well, in the first place, superb entrepreneurial leadership is far rarer than is generally supposed. Talent to steer an enterprise on a selected course is fairly common, but vision and courage, a thorough and intimate knowledge of the business and where it is headed, and a fierce identification of one's own welfare and reputation with the success of the business, such qualities, in combination, seldom occur. Unfortunately, this distinction between real entrepreneurship and mere business administration is not widely understood, not even at some of our most prestigious institutions in America.

Only two western railroads were led by talented entrepreneurs in the confused period from 1879 to 1895: the Southern Pacific, in Collis P. Huntington, one of those rare people who had not made a wrong move since he was 3 years old, as they say; and the Great Northern, in James J. Hill.

The Milwaukee had the misfortune to be controlled from the early 1880's on by two very rich men whose main interests lay elsewhere. These men seem to have valued their railroad connection, apart from its undeniable value as an investment, primarily because it qualified them as tycoons while they risked only a fraction of their huge fortunes and others did all the work. These men, who were both great successes in their original lines of business, were William Rockefeller, young brother of John D., and Philip D. Armour, the Chicago meatpacker.

Armour died in 1901 but Rockefeller remained influential in the Milwaukee until his death in 1922. Some years before, his place on the board had been taken by his son, Percy, who himself left the board in 1921. William had at least a sentimental interest in "his" railroad; but Percy, who went right on attending board meetings after 1921, when he was no longer a member, seems to have brought nothing to its management whatsoever. In fact, his ignorance of the road's affairs, as brought to light on the ICC's witness stand, was shocking. Even more shocking was the revelation that the Rockefellers had sold their holdings in the Milwaukee several years before, without even confiding in the Harkness family, also large investors in the Milwaukee, and associates of the Rockefellers in the petroleum business for many years.

Rockefeller and Armour made their major contribution to the Milwaukee's financial "image." With them in the picture, financing, both long and short term, was always easy to get. Various New York and Chicago bankers also served, notably members of the firm of Kuhn, Loeb & Company. None of these men had any firsthand knowledge of the railroad and could not have contributed much to strategic planning, the time for that having long passed in any event.

A minority of the board were operating executives, but they were not strategists and in any case seem to have been rather like estate managers who had graciously been invited to sit at the lord of the manor's table and who knew they were expected to speak only when spoken to.

I think, with that, I have dealt pretty well, as I refer back over this and according to my ad libbing, with the idea that the Burlington Northern formation in 1970 can have contributed anything to the decline of the Milwaukee. I fail to see how the de facto competitive relationships of the three so-called Hill roads with those of the western roads or the eastern roads with which they connected can have been changed by the actual formation of the holding company—I am sorry, of the merger in 1970.

I would like to close with some comments which are largely philosophical in nature. I am addressing myself to the question, how can we best provide for the well-being of western railroads?

The best guarantee that the people will continue to receive excellent transportation services, and that anticipated growth in traffic can be carried, lies in freeing the leaders of enterprises like Burlington Northern to pursue their profit opportunities as they see them, within established environmental criteria.

Should we fear that holding companies will dump hopeless railroad subsidiaries? Of course not. Where would they dump them? Who wants a dying railroad? On the contrary, the Penn Central bankruptcy taught railroad leaders a valuable lesson: if a railroad property declines in operating efficiency below a certain point, it will start to fall apart. They will have to keep it running; a railroad serves the public. And in the effort it may well devour the entire estate. They cannot afford to let that happen. A sick railroad in a holding company, Mr. Chairman, is like a sick elephant in the living room: it claims the family's full attention.

The leaders of the Burlington Northern know that their railroad, as Mr. Bressler has already said, can earn an attractive return provided they are able to equip the property for the bright future it faces and if the Government keeps the faith on deregulation. Every divisional head in the Burlington Northern should be able to say that the operating results of his division—railroad, trucking, air freight, forest products, petroleum, or what else you have bought in the last 45 minutes, Dick—reflect only his own efficiency or the lack of it. Top management should be free to reinvest the profits where their judgment dictates.

Under such an arrangement, the railroad will get its full share. As Jim Hill liked to say, "Every pot should sit on its own bottom."

Thank you.

Senator BAUCUS. Thank you, Mr. Martin. I can tell your classes are probably pretty full.

Mr. MARTIN. Until they get their first grades.

Senator BAUCUS. I appreciate that very much. Without objection, we will insert your prepared statement into the record.

[Material referred to follows:]

STATEMENT BY ALBRO MARTIN PRESENTED TO THE SUBCOMMITTEE ON AGENCY ADMINISTRATION OF THE COMMITTEE ON THE JUDICIARY OF THE UNITED STATES SENATE, MARCH 26, 1982

My name is Albro Martin. Before joining the academic community, I spent 17 years in business, in marketing and advertising research. I am now Oglesby Professor of the American Heritage at Bradley University, Peoria, Illinois. For six years I was professor of business history at Harvard University Graduate School of Business Administration, where I also edited the Business History Review. I have also taught at Columbia University, The American University, and the State University of New York. I am the author of both scholarly and popular articles on the impact of the railroad on the American political economy, and two books that deal in whole or in part with various aspects of railroad history, notably the consequences of public regulatory policy vis à vis the railroads, and the qualities of effective railroad leadership. My major work, published as a book in 1976 by Oxford University Press, is a definitive biography of James J. Hill, based on exclusive access to his complete private and business papers, in which I deal at length with the evolution of western railroad strategy and administration.

The Question before this Committee

As I understand it, the question before this committee comes down to whether the formation and operation of holding companies, themselves immune from government transportation regulation, whose major properties are railroads, will result in financial undernourishment of the railroads and thus in the failure to furnish adequate, efficient, low-cost transportation.

In this particular instance, as I understand it, evidence has been adduced, or at least hypotheses have been formulated, suggesting that the formation of Burlington Northern, Inc., as a holding company for the stock of Burlington Northern Railroad and such of the latter's subsidiaries, some in transportation and some not, as may be transferred to the holding company, may be expected to result in a long-term decline in railroad service to the vast and vital midwest and northwest sections of the United States that the Burlington Northern serves. It has been suggested that in the case of the Chicago, Milwaukee, St. Paul & Pacific Railroad, the formation of such a holding company has indeed resulted in depriving sections of the northwest of a vital transportation service. The Burlington Northern merger of 1970 is further thought to have contributed to the Milwaukee's distress.

The Milwaukee: A Century of Poor Management

The seeds of the decline of the Milwaukee railroad (until the reorganization of 1928 known colloquially as "the St. Paul") were planted as early as the first years of the most fateful decade in western railroad history--the 1880s. Since that time, even at the height of an enviable prosperity and apparent success, decisions both made and not made were continuing to seal the ultimate doom of this railroad as a viable, independent carrier. The Milwaukee's fatal weakness lay in those executives who formulated and put into effect strategic decisions. These men were, for the most part, only part-time executives, being directors, rather than fulltime professional managers, and men of great wealth and a variety of other interests; the Milwaukee had to compete for their time and attention, which was not always forthcoming and was frequently incompetent.

The Granger Years, 1860-1880.

The Milwaukee was one of several large "Granger" railroads that were quickly and inexpensively built through the states of the midwest (primarily Illinois, Wisconsin, Missouri, Iowa, and Minnesota) in the years following the Civil War, as these rich lands quickly filled up with settlers. The word Granger merely means "farmer," and these were indeed farmers' railroads, for their chief function was that of gathering up the harvest, and transporting it to one of the gateway cities (chiefly Chicago and St. Louis) where the Trunk Lines (New York Central, Pennsylvania, etc.) would take it East to the volume domestic market or to the docks for export; and to distribute to these same farmers the manufactured goods of the East on which farmers seemed to grow more dependent with each passing year. Each of the Granger roads prospered in a lucrative carrying trade based largely upon serving numerous points on an exclusive basis, and in carrying freight which was either short-haul, or originated or terminated at points served exclusively by a single line. This was the age of total ascendance by the railroad: no one went anywhere, or shipped anything, more than a few miles, without using the railroad.

The leading Granger roads were the Milwaukee, the Burlington, the Rock Island, and the North Western. It is vital to note that of these roads, one is defunct (the Rock Island); one (the North Western) has been "sold" to its employees and will sooner or later be a problem for policymakers unless the benefits of deregulation are speeded up; one (the Milwaukee) is in bankruptcy and withering away at its western extremities; and one (the Burlington) is the heart and bulwark of one of the most successful and progressive integrated railroad systems in the country. It is no accident that only the Burlington made a timely decision as to a transcontinental connection before the inflation of the pre-World War I decades removed the possibility.

The Era of System Integration, 1880-1901.

Beginning with the return of prosperity in 1879 (there was a serious depression in 1873-1878), the character of midwestern railroading began to change, at first slowly and then with increasing speed. By 1885 there were five completed transcontinental railroads, depending on how you define transcontinental: the Union Pacific-Central Pacific or "overland route," the first transcontinental; C. P. Huntington's Southern Pacific, with its terminal at New Orleans; the Union Pacific's branch, the Oregon Short Line, that made it a through route from Omaha to Portland, Oregon; the Santa Fe; and the Northern Pacific. In 1893 the Great Northern was opened and George Gould, having inherited his father's southwestern lines, was expected eventually to extend the Missouri Pacific and Rio Grande roads to San Francisco.

As a result of this hectic railroad development, which in the 1880s added several times as much route mileage to American railroads as had existed in total at the time of the Civil War, long-haul or through business began to dominate traffic. Since only the Santa Fe had its own rails all the way into Chicago, the Granger roads had the opportunity to carry most of this freight for several hundred miles on the eastern end. Transcontinental traffic was made feasible by low through rates. The great question was, how were these through rates (which worked out to a fraction of short-haul rates on a per-mile basis) to be divided between carriers? Where several carriers formed an end-to-end "alliance" of independent roads, the "divisions" were the result of sheer bargaining strength, and rates fluctuated violently without notice. It was no basis for orderly business operations. Accordingly, one of the Granger lines swallowed its pride of independence and tied up with its partners, on the theory that in business, as in life, a legal marriage is better than a common law arrangement.

I am referring, of course, to the Burlington, which through the sagacity of its president, Charles Perkins, and the Boston capitalists who had built it up in the 19th century, had formed a cozy relationship with James J. Hill's Manitoba road in the upper midwest even before Hill had made the decision to build to the coast. After Hill opened his carefully surveyed, economically built, and efficiently operated extension to Puget Sound, it was only a question of time before the obvious advantages of tying the Burlington and Great Northern knot tighter would be irresistible. In the depression of 1893-1898, when every transcontinental except the Southern Pacific and the Great Northern slid into receivership, Hill took control of the Northern Pacific and the die was cast. In 1901, Hill rejected J. P. Morgan's plea that he take over the Milwaukee, which Morgan feared would sooner or later grievously upset the railroad world as a result of its failure to formulate a grand strategy. Instead, Hill acquired the Burlington. Ever since, in spite of Congress, the Supreme Court, and public opinion, all of whom were mollified by the rather meaningless decision in the Northern Securities case of 1904, the three railroads have been operated as an integrated railroad system, and the people of the United States have been the beneficiary of Hill's remarkable vision.

Prosperity of the Progressive Era.

The period from 1898 to 1920 was one of great prosperity and rapid economic growth for the United States. The farmer benefitted handsomely from bumper crops, sold at record prices, and the oldline Granger railroads wallowed in prosperity. Their affluence is almost tragic, in retrospect, for it masked the grave dangers into which the North Western, the Rock Island, and the Milwaukee were heading. By the end of World War I, intermodal competition was ending the railroads' monopoly forever, and the handsome profitability of the Granger roads would evaporate, slowly during the 1920s, and then precipitately during the depression.

The tragedy was compounded when the operating executives of the Milwaukee road, who had always felt keenly the lack of a transcontinental connection, persuaded the board of directors of the road to build to the Pacific. James J. Hill had extended the Great Northern at bargain prices, enjoying the lowest costs for supplies, equipment, and labor in the entire post-Civil War period. The Milwaukee made its decision only in 1905, and by that time prices were roughly 25% higher than at their depression lows. What was worse, the Panama Canal was finally making progress across the Isthmus. Piling bad decision upon bad decision, the Milwaukee heeded the rosy predictions about the future of electrification that were being made by leaders of the copper industry, one of whom was a member of the Milwaukee board. In territory that never developed the kind of traffic density that such a large investment as electric traction requires, the Milwaukee electrified hundreds of miles.

Evidences of Poor Management

The Milwaukee board accepted the verbal estimate of the cost of building the Pacific extension, as presented by operating management, without demanding anything like the exhaustive engineering studies that would be standard procedure today. The $60 million estimate, which was based apparently on nothing but the president's opinion, was exceeded four times over, producing a cost overrun that would draw gasps even in our modern era of cost overruns. Meanwhile, several costly acquisitions of useless branch lines had been foolishly made.

The Milwaukee in the Era of Intermodal Competition, 1920-Present.

Whether the Milwaukee would have recovered from its long-term downward slide after 1920 if no new factors had entered the picture, is a useless question, for the simple reason that in business new factors are always entering the picture. The extension might have been carried at a manageable loss if the basic profitability of the old Granger lines had not been destroyed. But it was destroyed, and very largely by Detroit and Washington, for what the coming of the motor truck did not do to destroy the profitable traffic of most American railroads, regulation as carried out by the Interstate Commerce Commission all but finished it. By the early 1920s, the "smart money" was being pulled out of the Milwaukee.

World War II and the liquidity that it engendered for the railroads, gave them a reprieve, but by 1950 the long-term trends had reasserted themselves. By the mid-1950s nobody in the know believed that the Milwaukee, or the North Western, or the Rock Island had any future. The ICC, in its role as judge of whether mergers are in the public interest, procrastinated so scandalously as to justify its abolishment, and the merger route was effectively shut off for most of the old Granger roads. Whether one chooses 1890, or 1905, or 1928, or 1932, or 1950 as the date by which the ultimate fate of the Milwaukee had been sealed, it seems clear that restructuring the corporation within a holding company after 1970 can have had very little to do with the outcome.

Why was the Milwaukee Mismanaged?

Superb entrepreneurial leadership is far rarer than is generally supposed. Talent to steer an enterprise on a selected course is fairly common, but vision and courage, a thorough and intimate knowledge of the business and where it is headed, and a fierce identification of one's own welfare and reputation with the success of the business--such qualities, in combination, seldom occur. Unfortunately, this distinction between real entrepreneurship and mere "business administration" is not widely understood.

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Armour died in 1901 but Rockefeller remained influential in the

Milwaukee until his death in 1922. Some years before, his place on the board had been taken by his son, Percy, who himself left the board in 1921. William had at least a sentimental interest in "his" railroad, but Percy, who went right on attending board meetings after 1921, seems to have brought nothing to its management whatever. In fact, his ignorance of the road's affairs, as brought to light on the ICC's witness stand, was shocking. Even more shocking was the revelation that the Rockefellers had sold their holdings in the Milwaukee several years before, without even confiding in the Harkness family, also large investors in the Milwaukee, and associates of the Rockefellers in the petroleum business for many years.

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How Can We Best Provide for the Well-being of Western Railroads?

The best guarantee that the people will continue to receive excellent transportation services, and that anticipated growth in traffic can be carried, lies in freeing the leaders of enterprises like Burlington Northern to pursue their profit opportunities as they see them, within established environmental criteria.

Should we fear that holding companies will "dump" hopeless railroad subsidiaries? Of course not. Who wants a dying railroad? On the contrary, the Penn Central bankruptcy taught railroad leaders a valuable lesson: if a railroad property declines in operating efficiency below a certain point, it will start to fall apart. They will have to keep it running--a railroad serves the public--and in the effort it may well devour the entire estate. They can't afford to let that happen. A sick railroad in a holding company is like a sick elephant in the living room: it claims the family's full attention.

The leaders of the Burlington Northern know that their railroad can earn an attractive return, provided they are able to equip the property for the bright future it faces and if the government keeps the faith on deregulation. Every divisional head in the Burlington Northern should be able to say that the operating results of his division--railroad, trucking, air freight, forest products, or petroleum--reflect only his own efficiency or the lack of it, and top management should be free to reinvest the profits where their judgment dictates.

Under such an arrangement, the railroad will get its full share. As Jim Hill liked to say, "Every pot should sit on its own bottom."

Thank you.

Senator **Baucus**. Mr. Bressler, I appreciate your testimony, too. I also understand your point that the holding company structure allows managers to focus on various areas. As Mr. Martin said, every pot should sit on its own bottom. I also want to encourage Mr. Grayson, who has done a good job, I think, on the railroad side, to continue in that area, too. That is the heart of what we are doing here. I appreciate Mr. Grayson's efforts very much.

As you could tell from some of my questions that I asked Mr. Krueger and Mr. Taylor, I am somewhat curious about the timing of BN's announcements concerning the holding company. I am wondering why did BN wait a month or so after approval of the Frisco merger to announce the decision to form a holding company.

Mr. **Bressler**. I am not sure that I can give you a complete historical perspective on that. I think, in terms of my reasoning about it, it is simply when you are involved in a major merger, as the merger of the BN and the Frisco was, it occupies a lot of your time. Obviously, you want to get that accomplished in terms of all the things that are important to make that work. I think there is an orderliness to most of the things that we try to do in any business. You set your priorities and take them accordingly.

At the time that I joined the BN, of course, the Frisco and the BN merger had been under way for some time. There were a lot of internal studies and work to make sure that that was accomplished.

I think it had been the intent of management to consider a holding company for some time but had just put that on the back burner, so to speak.

Senator **Baucus**. I am asking the question because I am wondering if by so informing the ICC that would have given interested parties a chance to air their views and perhaps resolve some of the holding company questions that are now floating in the air, maybe even obviate the need for this hearing.

Mr. **Bressler**. Senator, I think you can tell from my remarks, I must admit, I have been somewhat surprised by the amount of concern for simply a holding company. I think I tried to indicate what the very simple reasons were for which we formed it. There really has been relatively little change other than that.

I appreciate that the ICC version is that securities can be issued for other than railroad purposes. I guess my way of approaching that—let us take as an example Fred Winegar and Plum Creek. Fred operates that business in a very competitive atmosphere today. I think we all know how competitive the forest products business is. In fact, they are so competitive that they are all running in the red. But, at the same time, he has to compete with other people who are not similarly hampered by the fact that they would have to go to the ICC if he should want to merge with another company, if he should wish to issue securities, to acquire, to build up his own company. I think, from my standpoint, I want his business to operate in the same competitive arena that he has to compete with across the board.

I think it was a disadvantage to have Plum Creek encumbered by the necessity to go to the Interstate Commerce Commission even though they may well have approved it several months after the application. It just represents another competitive impediment.

Senator **Baucus**. Are you agreeing or disagreeing with the statement of Mr. Taylor that ICC, as it interprets the present statute, does not require issuance of securities to be only related to transportation efforts? That is, the securities could be issued for nontransportation activities so long as there are—I have forgotten the qualification here. My recollection is that it is so long as there is a relation here of some kind or some public purpose here.

Mr. **Bressler**. I am not an expert on it. I think I would just refer again to what I see as a competitive disadvantage in the necessity of filing an application with the Interstate Commerce Commission for something which really does not pertain to transportation. There is delay if nothing else.

Senator **Baucus**. But does not this somewhat go into the question of just disclosure? I mean, companies file with the SEC when they want to issue securities. It is a disclosure function. It is not that the ICC gives or does not give approval. The ICC does not have the authority generally to disapprove an application to issue securities.

Mr. **Bressler**. I think that is a good question to ask Mr. Taylor, if he would compare the time in which the ICC acts on those kinds of applications versus the SEC. My guess is that you will find that the SEC is much faster in approving those applications.

Senator **Baucus**. There is no doubt about that, that is right. That is very true. I think it is attributable in part to a difference in statutes. I think the securities statutes and even the regulations the SEC, if not require, at least give strong impetus to early approval by the SEC.

I am just wondering if perhaps we could have avoided some of these questions if the railroad had gone to the ICC and indicated that, subsequent to the merger, they would be applying for holding company status.

Mr. **Bressler**. Possibly that is true. As I say, I must admit I have been somewhat surprised by the amount of controversy over something that I think in my mind should not have been so controversial. Obviously, the Burlington Northern was about the last of any of the major carriers to take the same action.

Senator **Baucus**. Would it impair BN's performance to have a careful, continual ICC review of the holding company's financial operations, that is to insure that rail service is continuing at a quality level?

Mr. **Bressler**. Do you mean monitoring of the railroad?

Senator **Baucus**. Yes.

Mr. **Bressler**. It is subject to the ICC's full jurisdiction.

Senator **Baucus**. It is monitoring the holding company now, not the railroad.

Mr. **Bressler**. I think there again my remarks would be about the same. The rest of our businesses in the nontransportation businesses, we have to compete with businesses which do not have similar encumbrances. To the extent that any regulatory agency requires more administrative burden and cumbersome procedures, then I think that is a competitive disadvantage.

Senator **Baucus**. What about the obligation to the public to provide service? Is not there another side of the coin? I ask the question because in your statement you said you agreed with the point I made, the dual role of the railroad. What about the other side of that coin?

Mr. **Bressler**. We believe it is perfectly proper, there is no question about it, the railroad is subject to ICC jurisdiction. We comply with the Commission's regulations and comply with the law.

Senator **Baucus**. You are saying that, yes, there should be regulations?

Mr. **Bressler**. With respect to the railroad?

Senator **Baucus**. With respect to the railroad, that is correct.

Mr. **Bressler**. We think that there should be a fair amount less regulation, and apparently the Congress agreed with that thinking last year with the passage of the Staggers Act.

Senator **Baucus**. Do you think there are too many burdensome regulations affecting the railroad operations today of the BN?

Mr. **Bressler**. I would like to ask Mr. Grayson to comment on that. He runs the railroad.

Mr. **Grayson**. We are still just trying to find out where we really stand in what has been called deregulation. While it is not complete deregulation by any sense of the word, we have less regulation than we have had in the period when I grew up in the railroad business. However, there are some areas where we think we could still stand less regulation than we have now.

Senator **Baucus**. Has not the railroad in the past depended upon its natural resource profits to help the operations of the railroad?

Mr. **Bressler**. The railroad——

Senator **Baucus**. Particularly to cover its fixed costs?

Mr. **Bressler**. No, not to my knowledge. Do you mean back in time? I think the real thrust of what you are asking there has to do with the fact that the railroad has invested a great deal more money in recent years, particularly in its ability to haul coal, than might have been granted to it by virtue of the railroad operations by itself. Even last year, despite the fact that the railroad generated more income dollars than it has, I guess, ever, our rate of return on that capital employed, which I think is really the only reasonable measure by which a capital-intensive business should be measured, was less than 5 percent.

Again, though, I would cite the fact that that does not mean that we will not invest in the railroad in the future. That is the return on the sunk capital that has been invested in the railroad ever since day one.

We look at the rate of return we expect the capital to earn if we invest it in the railroad or any of our other businesses. I think that is the only proper way that you can make those kinds of allocations or resources.

Senator **Baucus**. The point I am trying to establish is that the railroad in the past has depended upon natural resources earnings.

Mr. **Grayson**. I do not think there has ever been a time when the railroad was not able to meet its obligations on its own, at least on an ICC reporting basis.

Senator **Baucus**. How great have natural resource contributions been to the railroad in the past 10 years?

Mr. **Bressler**. I think we will have to compile that information, Senator. I think last year, as I indicated in my testimony, the railroad is 75 percent, for instance, of earnings and cash flow. It has been a very large proportion for some period of time and will continue to be.

Senator **Baucus**. I would appreciate if for the record you could, on an annual basis for each of the last 10 years, provide that.

[See appendix F at page 663 in the appendix.]

Mr. **Bressler**. I would be happy to do that.

Senator **Baucus**. Without objection, it will be inserted into the record.

What do you say to shippers and laid-off rail employees who argue that BN is storing up to $1 billion for natural resource acquisitions and development by reducing rail services and reducing rail employment? I mention this because in an article in Business Week of March 8 there is a graph there which lends one to that kind of interpretation. It cites a 13-percent reduction in labor force, extensive abandonments, and a drop in capital expenditures on the railroad.

Mr. **Bressler**. I think, again, I have talked about that in my testimony. Our interest is increasing the profitability of the railroad to make it productive and efficient. Certainly, I think we see all about us in today's economy how industries, if they do not strive to be the most cost efficient producers, they certainly do not provide any security for their employees. I think that the record is replete with those kinds of industries and those kinds of companies.

We think it is tantamount to make sure that our company, the railroad, and all of our businesses are financially strong and cost competitive. That is the only way that we can really assure anyone of a continuing job.

Senator **Baucus**. But is it true that $1 billion cash is being built up?

Mr. **Bressler**. No, I cannot be responsible for how the media interprets things. That was not my statement, also the statement about the cash——

Senator **Baucus**. I do not know whose statement it was. I am just asking whether it is accurate and to what degree it is accurate. I do not care who made the statement.

Mr. **Bressler**. I think our cash position today is right around $300 million, quite a ways from $1 billion.

Senator **Baucus**. What is your intention with respect to that cash. Is that going to the railroad or elsewhere?

Mr. **Bressler**. Right now it is going to be returning a fairly healthy return in short-term securities. We have a very substantial capital program. Again this year the railroad will be issuing debt securities, probably equipment trust securities for equipment to be bought. So, you know, cash is not coming out of our ears, so to speak.

Senator **Baucus**. I asked the question, again, because of the speculation that some of that might be built up to acquire an oil company or for some other purpose that is other than to the railroad.

Mr. **Bressler**. In today's times, when we are operating in the kind of an economy we are, we feel very fortunate to have the kind of cash position that we have. But we do not have any billion dollars of cash.

Senator **Baucus**. You also stated that productivity improvements require further trimming of the labor force. I note that you have fewer employees with the combined BN-Frisco than BN had alone in 1970. How many more jobs will be terminated over the next 5 to 10 years?

Mr. **Bressler**. I am not sure that any of us have any great predictions on that. I will ask Mr. Grayson to comment on it. I think, though, that before he does I will just say that, by any number of measures—and I think there have been previous questions and testimony to the fact of what happens in terms of the merger benefits. A lot of the reduction of employment has occurred because of the consolidation of shop facilities that has occurred as a result of the 1970 merger. Many of those have just occurred in the last year or so. Dick, do you want to comment?

Mr. **Grayson**. We have no set number. Obviously, a lot of the people that are unemployed today in our company are because of a severe decline in business. The economy affects us probably earlier than it does most businesses. Grain exports have been very poor. Our coal business was off the first 2 months of the year. But I think in the long run a lot of the people that we did take out of our work force last year probably will not come back, at least unless they come back to replace someone who may retire. It would be an attrition program.

The reason for all this was that Burlington Northern did not rank well in their peer group in productivity levels and almost any measurement that we looked at. It was our purpose to certainly be as good as the average of our peer group. In fact, we have one definite goal in mind that we intend to, as Jim Hill said almost a 100 years ago: If you want to be in this business, you have got to be the low-cost producer. If we are going to do our job well, I think it is incumbent upon us to do those things that put us in that position.

Senator BAUCUS. Could you identify some of the other productivity improvements that require further reduction?

Mr. GRAYSON. Well, the things that we have done primarily are through automation.

Senator BAUCUS. I mean those in the future. As you say, there are other productivity improvements that require further reduction.

Mr. GRAYSON. We certainly did not get there in a year. You do not do these things in a year. It takes a year to get a lot of the equipment that it takes for us to do things. We are talking about new types of machines that were not onboard for our shops. We are spending $17 million this year for improved and newest state-of-the-art machines for maintaining our track structure. We are talking about advanced design computers that we are using in many more places than we have in the past to improve our information system to better handle our cars and our locomotives. These are the types of things that we are spending money on and will continue to.

Senator BAUCUS. Still, cannot you give me a ballpark estimate as to what the further reduction in labor force will be?

Mr. GRAYSON. No, sir, not unless you can tell me how much business we are going to be doing because that is the great unknown in this.

Senator BAUCUS. Still, you made the statement that there will be further trimming of labor force. What does trimming mean? That is the company's statement.

Mr. GRAYSON. Well, this goes on and on. You know, I do not know. As new machines and better ways of doing business are discovered, we are going to try to take advantage of them. For example, our wage ratio last year was some 12 or 13 points higher than the best railroads such as the Southern and the Norfolk & Western.

Mr. BRESSLER. I think that is perhaps doubly significant in view of the kind of business that the Burlington Northern Railroad——.

Senator BAUCUS. I am sorry, Dick. I am having a hard time hearing you.

Mr. BRESSLER. I think that is particularly significant in view of the fact that the Burlington Northern Railroad's principal business is the movement of grain and coal, which increasingly operates in unit trains which you would expect to be the most efficient way to do it. And we do expect those to be most efficient. So, when we compare ourselves with railroads that are not similarly situated, then we ask ourselves what efficiencies are we missing? I think a lot of it has to do with the kinds of things that Dick alluded to.

Senator BAUCUS. I am just trying to understand. Will there or will there not be further reductions in labor force? Are there today planned reductions of labor force?

Mr. GRAYSON. There is no one in our company that has a quota of people that he must reduce. This is only as we can find ways to improve productivity. I have no number. There is no number in our company anywhere.

Senator **Baucus**. You could not tell me whether it would be 10, 100 or 1,000?

Mr. **Grayson**. It may be a little north of that.

Mr. **Bressler**. I am sure you are concerned with the kind of situation that we have in Plum Creek, which is almost total employment in Montana. Maybe Fred Winegar would talk a little bit about what he is doing and what he sees as the employment situation.

Senator **Baucus**. I appreciate what Fred is doing. He has a whole separate special set of problems, with the forest products industry in such rotten shape as it is today.

Mr. **Bressler**. The railroad, I think I commented, has thousands of cars and hundreds of locomotives idle. We would like to have those all employed, but the truth of the matter is there is not enough business to keep them employed.

Mr. **Grayson**. I would say that one of the other things we are doing in demonstrating our faith in the future of this business is this: In the past 2 years, even with the surplus of equipment, as Dick said, somewhere between 400 and 500 and at one time over 500 locomotives stored serviceable, we bought new locomotives last year and this year. If we are going to be in business, we have to be as good as anyone else and hope for the best. So, we are putting our money back into this equipment and taking out the older, less efficient, less fuel-efficient, higher maintenance units.

Senator **Baucus**. Have you developed a rail-cost-reduction plan?

Mr. **Grayson**. A what?

Senator **Baucus**. A rail-cost-reduction plan.

Mr. **Grayson**. Do you mean the labor of laying rail? You bet.

Senator **Baucus**. Just generally any plan to reduce costs.

Mr. **Grayson**. Oh, yes. Yes, indeed. That is what we are spending a lot of money in our maintenance and machinery on. Our cost of laying a mile of rail was probably 40 percent higher than it should have been. The cost of putting a crosstie on a track, of which we put in about 4 million a year, was about twice what we thought it should be. This year we hope to achieve the goals of reaching those levels of productivity. What this simply means to us is that we do get more bang for a buck. We get more miles of track, more miles of rail, and more crossties.

Senator **Baucus**. What effect will those have on the number of employees?

Mr. **Grayson**. Of course, a lot of these people, you have to understand, are part-time employees. In our territory much of the work has to be done in the summer. We will stabilize employment for a great many of our employees because we were able to work out with our labor union some regional rather than divisional gangs. With the addition of Frisco to our system and by closer examination of some of the work areas that we can extend our work periods, we are going to sort of level out some of the maintenance cycles that we have traditionally had on the Burlington Northern.

I think the end result is that, while we may have fewer overall people in maintenance, we are going to get a higher quality of work. The people that are doing those jobs are going to be riding a machine and work a very high technology machine and being paid more than those guys who were trying to hit it with a sledge and a shovel.

Senator **Baucus**. As you know, in rail merger proceedings the Commission spends a considerable amount of time deciding what level of benefits a merger will produce. I gather from your testimony that BN has been unable to count up the dollar benefits of the 1970 BN merger with any precision. If that is so, I am curious as to how it is that the BN was able to assert that the merger would produce $40 million in benefits when the merger was pending before the Commission.

Mr. **Bressler**. Are you referring to the recent merger with the Frisco?

Senator **Baucus**. No, the 1970 merger. The Northern Lines merger.

Mr. **Bressler**. I really do not have any comment on that, Senator. That is past events, as far as I personally was concerned. Frank, do you have any comments?

Mr. **Farrell**. Yes. Outside consultants were engaged to make the study. Their study consumed some 18 months. They testified under oath to that effect and were extensively cross-examined. That is a part of the record. The Commission based part of its findings in approving the merger upon that testimony.

Senator **Baucus**. As I understand you, you are saying consultants spent 18 months but did find asserted benefits at that time.

The question arises, how can the applicant find all these benefits but the Commission or apparently the railroad now cannot attribute a dollar value to benefits. Generally, hindsight is better than foresight.

Mr. **Bressler**. I am not sure that we can.

Senator **Baucus**. Now it is the other way around.

Mr. **Bressler**. What are you referring to? What response did we give that indicated that we could not identify them?

Senator **Baucus**. I am referring to your testimony where you say it is very difficult to attribute a dollar value to benefits.

Mr. **Bressler**. I think it is. It is difficult. I think attempts have been made in the past.

Senator **Baucus**. I agree with you it is difficult, but the question is what are the——

Mr. **Grayson**. I think it is easy in the case of our latest merger. Certainly, we identified the places where we were going to reduce duplicative personnel. We were going to do it by attrition. That is what we have been doing. Those are easy to identify. The changes that we contemplated and which Chairman Taylor, I believe it was, spoke to are changes in traffic patterns. Certainly, that is a part of this business. You know, if you do not have any volume in this business, you only have one place to go, and that is broke.

Senator **Baucus**. Could you for the record give us the dollar value benefits of the merger? We have not time to get into it here. I know it is difficult to identify them, but I think it would be helpful if we could. Also, please furnish the source of those estimates.

[See letter of May 25, 1982, to Senator Baucus at page 638 in the appendix.]

Mr. **Bressler**. It would certainly be much easier, I think, because it is so much of a current event, with respect to the Frisco merger, the more recent one——

Senator **Baucus**. I appreciate——

Mr. **Bressler**. Going back to 1970, certainly that becomes a little more difficult.

Senator **Baucus**. I would like them for both, actually, 1970 as well as the Frisco.

Mr. **Bressler**. We will make a stab at it.

Mr. **Grayson**. I think the thing that makes it so difficult from 1970 merger, Senator, is the fact of the very disproportionate expenditures that had to be made by Burlington Northern in areas that were really not planned to tool up for the massive amount of coal that we are now hauling out of the Powder River Basin and then over the corridors that gets it to the utilities or to the connections. That, obviously, affected earnings because of the system of accounting we use. A great deal of those expenses were charged to operations where in most industries, I suppose, a major part of them would have been capitalized.

Senator **Baucus**. I appreciate that. It would help this committee a lot if you could undertake your best effort.

Mr. **Bressler**. We will research what we have and get back to you with a response to it.

Senator **Baucus**. Without objection, that will be made a part of the record.

Senator **Baucus**. Could any of the merger benefits of the appendix to your testimony been achieved without the merger?

Mr. **Bressler**. Would you identify which ones you are referring to?

Senator **Baucus**. On pages 10 to 14 you mention a number of Northern Lines merger benefits.

You could do that for the record instead of spending the time here, without objection.

[See page 645 in the appendix.]

Senator **Baucus**. What is the approximate market value of properties that you indicate were transferred from BN-Frisco to the holding company?

[See page 641 in the appendix.]

Mr. **Bressler**. I am going to ask Frank Farrell to answer that.

Mr. **Farrell**. At this time, Senator, I think Mr. Bressler indicated in the appendix to his testimony that the properties have not been transferred. The properties are owned by the railroad. What the railroad has done with the holding company is enter into a tripart management agreement. So, for example, the BN Timberlands is managing the timber-growing properties of the railroad, but the railroad has fee title to those properties.

The result is that the railroad management is able to devote its time to the operation of the railroad property while the timber group is devoting its time to the management of the timber properties.

Senator **Baucus**. I am asking actually with respect to the Frisco properties, the market value of the New Mexico & Arizona Land Co.

Mr. **Grayson**. What was the market value in New Mexico & Arizona Land Co.?

Senator **Baucus**. Of the other properties that were transferred.

Mr. **Bressler**. The interest the Frisco held in the New Mexico & Arizona Land Co.

Mr. **Grayson**. The Frisco owned 50.03 percent of 2 million shares of New Mexico & Arizona Land Co., which is in the resources business and real estate business in northeastern Oklahoma, some various other parts of New Mexico, and a little bit in southern Arizona. Today on the market we own 1 million shares of it. It is worth about $11, I think. It has been as high as $50, $55. It is a highly speculative stock for reasons best known to those people who buy it.

Mr. **Bressler**. That stock trades on the American?

Mr. **Grayson**. Yes, the American Exchange.

Mr. **Bressler**. If somebody has a paper, we can look it up. It has gone down considerably in recent months.

Mr. **Grayson**. If this is what you are searching for, these lands originally came from part of an old Atlantic & Pacific land grant. The Frisco & Santa Fe were both a part of a company known as Atlantic & Pacific which broke up in 1893 or 1895. Our friend, Albro, here probably knows the history better than I. We came out and formed this company as an offshoot of those land grants.

Mr. **Bressler**. I am told that the stock closed yesterday at 11⅝, which would put the approximate value at $11 or $12 million.

Senator **Baucus**. BN owns some 2.3 million acres of surface and about 6 million acres of mineral rights, not counting properties acquired with the Frisco merger. Can you give us a ballpark estimate for the current market value of BN's natural resource properties?

Mr. **Bressler**. It is a good question, and I wish I could. You start with——

Senator **Baucus**. I wish you could, too.

Mr. **Bressler** [continuing]. This kind of a problem, Senator. We compile in our annual report what we think are the recoverable reserves of subbituminous and lignite coal on those lands. And it is true that we can add up those figures and, to the degree to which they are accurate, I suppose, are plus or minus 10 percent. Many of those reserve figures have not been verified by the kinds of drilling and what not that would be required to do it.

Nevertheless, the big question is, what is the present worth of those holdings? I think that that is a much more difficult question to answer. As you know, very little of the Burlington Northern coal is currently being mined. I think our expectation is that relatively little would be mined in the near future, given the present economy, the present glut of existing mines that have additional capacity to produce more coal, and the sheer fact of the differential that exists between the two States, Wyoming and Montana, because of the severance tax. More of the coal development has gone forward in Wyoming. So, to the extent that you are looking at the economies there, the chances are more coal will be developed south of the State line than will be north of it.

That all complicates this question of what is the present worth of it.

Senator **Baucus**. You are not opposed to our severance tax, are you?

Mr. **Bressler**. No, I am not. I am not taking a position on that. I get in enough trouble without taking a position on severance taxes.

Senator **Baucus**. I know it is tough to give the present worth. It is very difficult for the reasons you mention. Still, you do have 12 billion tons of strippable coal. Even if coal is only $1 a ton——

Mr. **Bressler**. That is debatable, though, because of the feature——

Senator **Baucus**. I know, given some percentage——

Mr. **Bressler**. Well, no, it is the feature in which our ownership occurs because of the checkerboard pattern of the land grant. If you were ready and willing to mine that coal today, I think you would find that most people would say that is not in a minable fashion because you cannot develop an efficient mine plan where you have to mine every other section.

Senator **Baucus**. Is it BN's position that there are no continuing obligations of any kind rising out of the Northern Pacific land grant?

Mr. **Bressler**. Continuing obligations?

Senator **Baucus**. Yes.

Mr. **Bressler**. No, we do not recognize any continuing obligations.

Senator **Baucus**. Just for the record so we are clear where we are starting from, it is the BN's view that there are no continuing obligations——

Mr. **Bressler**. I think it is not just our view but that of all the people in the Congress who have looked at it over time. I think you know that it has been reviewed fairly extensively. I have not personally read the committee reports on those. I have read within the year a thesis written by a well-known Montanan by the name of Theodore Schwinden, who concluded the same thing, that the public received fair value for the bargain that was struck.

Senator **Baucus**. There are others who take the view. But, as you know, there are many, including some in this room, who are probably going to testify this afternoon, who have a contrary view. I am just trying to help them out by finding out what your view is today at this moment.

Mr. **Bressler**. That is our view.

Senator **Baucus**. Thank you very much.

In your view, did the BN merger have any adverse effects whatsoever on the financial condition of the Milwaukee, notwithstanding Mr. Martin's useful presentation?

Mr. **Bressler**. My perspective on that, again, is limited because of my relatively short period of time. I guess I would ask either Dick Grayson or Frank Farrell if they wish to make a comment about it.

Mr. **Grayson**. I think that the Milwaukee's fate, as Albro recited, was pretty well put in place before 1970. They were having troubles trying to suffer through. Had it not been for the prosperity of all of us through the period of World War II, they probably would not have made it that long. They simply could not be competitive. They did not put the money into the railroad to provide the physical plant that could make them competitive on a transcontinental basis. Maybe they will make it now where they are, and I certainly hope that they do in a reduced system.

Senator BAUCUS. Do you think the BN merger furthered the decline, hastened the decline in any way?

Mr. GRAYSON. I would think that the reverse would be true because out of the Northern Lines merger came some traffic conditions and trackage rights conditions which gave them some new markets. It was designed to help them; they got pretty well what they wanted. So, I certainly——

Senator BAUCUS. I was asking because you were here, I am quite confident, when the Assistant Attorney General testified. He said that he felt that, yes, it did have an adverse effect. It may be in some technical way. The result of his department's study was that it was nothing that was actionable but probably had, at least as I recall, some technical violations, is what he said. One could infer from that that those violations were detrimental to the Milwaukee, I do not know. I am just curious. I do not think you are going to find yourself liable to any action by admitting some adverse effect on the Milwaukee. I am just curious if honestly, in your view, the merger had some adverse effect on the Milwaukee Road.

Mr. GRAYSON. Well, to the extent that better routes produce better service that the public benefited from and that traffic flowed to the BN, I think, theoretically you could say that that would have had an adverse effect. But I believe what Mr. Baxter said was that, except for a few isolated cases which were technical in nature, they found no violations of any of the conditions that were imposed by the Commission in the Northern Lines case, on which, I think Frank Farrell will tell you, we spent over 35,000 pages of evidence.

Senator BAUCUS. Does BN plan to sell its air freight forwarding operation to Pittston in order to raise money to acquire an oil company?

Mr. BRESSLER. That is what I call a loaded question, Senator.

Senator BAUCUS. Loaded but widely reported.

Mr. BRESSLER. We have signed a letter of intent to sell our air freight forwarding company to the Pittston Co. That is correct as reported. The transaction has not been consummated yet, but we expect it to be so.

We are selling it simply because the buyer valued that business more than we did. We thought it was a good price for it.

Senator BAUCUS. Is BN shopping for acquisitions?

Mr. BRESSLER. I would not say that we are shopping. We are certainly looking. I have made no secret of the fact that we are looking, for instance, in the resource-related area. As an example, you cited the acreage that we have on which we own mineral rights. The practice in the company up to the last year or so has been that we were a royalty owner rather than an operator. I happen to think it is advantageous for us to be in a position to explore some of that property ourselves. We think it is going to be more profitable for us. It is very difficult in these days to build an organization to do that. The kinds of people that are required are in demand by many other companies. I think it is a well-known fact that it is cheaper, easier, and faster to acquire an existing organization than it is to try to build one.

Senator **Baucus**. Is BN considering selling any portions of its transportation business?

Mr. **Bressler**. Other than the air freight forwarding company, no.

Senator **Baucus**. I am not going to wake up some morning and find that you sold the railroad?

Mr. **Grayson**. Last night on the——

Mr. **Bressler**. Did you hear that rumor? No, I have not heard that rumor. No.

Senator **Baucus**. For a year or so there have been rumors in BN territory that BN might go into the coal slurry pipeline business. Has the BN changed its position from firm opposition to coal slurry legislation to some other position with respect to coal slurry legislation?

Mr. **Bressler**. I am glad you asked that question because I think, again, there has been some confusion on what that position has been. My position is this. Other things being equal and if a coal slurry line is the lowest-cost producer of transportation, then indeed that is what we should have. I think in the question of other things being equal, you have to take into account that the part of the country, in particular the Powder River basin and eastern Montana, involved, the question of water for slurry becomes an overriding concern. On the other hand, I have suggested to some of our operating people because I am so interested in seeing the export of some of our coal, we have a problem of, in terms of cost, moving coal over the Cascades.

If you start to look at where is the most desirable place to have a coal-export facility, ultimately we believe that coal will move in the same size ships that oil perhaps does. This requires deep water. Therefore, it seems advantageous, if you can, to develop a coal-export facility on Puget Sound, which has deeper water than the Columbia River. But there is a cost tradeoff there at present. Simply, we have said, well, what would be the possibility of bringing the coal by rail to some point where water is not of great concern? Perhaps the Columbia River. Put it in a slurry line. Maybe that is the way to move it.

I think there are other very interesting ideas about it; so far they are just ideas. I have talked with the Mitsui Co., as an example, who has some interesting ideas about how to convert the moisture content in Powder River Basin coal into methanol and to utilize a coal-methanol type of a mixture.

Again, we have no opposition to lines of that kind if they make good economic sense. Where we do have concerns is in the case where special privileges, in our view, are being asked such as to operate as a private carrier as opposed to a common carrier, which we are. We also have concerns where that situation overlays where large investment has already been made in rail facilities to haul coal.

I take the position that this country needs the lowest cost transportation that we can have to move those very vital commodities. We do not need redundant transportation systems, particularly if they have to be built on the basis of some additional privilege.

Senator **Baucus**. That is interesting to know. It has always been my impression that BN has been very much opposed to coal slurry legislation. I now hear you saying that you are more open to it, depending upon the circumstances.

Mr. **Bressler**. I think historically, though, the BN early on had an equity position in the so-called ETSI coal slurry line. It goes back a number of years.

Mr. **Grayson**. I think what we are really saying, too, Senator, is that we all ought to play from the same rule book. The right of Federal eminent domain is one which we oppose vigorously. Again, the right of a private carrier, cream skimmer, taking what you want and leaving the rest to the railroad, is what we are opposed to. Otherwise, there is no reason why they could not be out there building a coal slurry line today.

Senator **Baucus**. I appreciate your earlier statement, Dick, when you said that the BN is not now trying to retire or alter the old land grant bond indentures. Is that being contemplated, though, for the future?

Mr. **Bressler**. We have looked at those indentures in the past and periodically look at it. The problem, as I understand it from the indenture, there is no call provision on those bonds. So, that is the particular impediment even if we wanted to retire the bond issue. They are pretty good rates, you know, 3 percent due in 2047.

Senator **Baucus**. Again suggested in Business Week, is BN considering or acting on an approach that involves depositing cash or other collateral with the bond trustee in order to free BN from bond restrictions?

Mr. **Bressler**. There is an enormous amount of speculation. I think it was fueled at the time of the holding company formation, that somehow we had a problem with those bonds that we had to solve one way or another. So, there has been a lot of speculation in the markets. Those bonds are traded on the New York Bond Exchange. You see articles similar to the one that you cited in Business Week. The fact remains that, because of the vast investment that has been made in recent years in those Northern Pacific railroad lines, we have established credits, if you will, with the trustee toward which we can apply these proceeds from the resources. We expect that that will not be a problem for several years.

Senator **Baucus**. What is going to happen in several years?

Mr. **Bressler**. Maybe there will be a problem. I do not know. We are not that far-seeing. It is not a current problem.

Senator **Baucus**. Are you at all worried that in building up cash and forming a holding company that you might be setting BN up for acquisition?

Mr. **Bressler**. Oh, periodically there are rumors about that we might be the target of an acquisition. I do not think that it is necessarily just because we have some cash that would make it so. I think we are regarded as a pretty good property. But, to my knowledge, nothing has ever materialized in that regard.

Senator **Baucus**. I appreciate your testimony, all of you, very much. I know all of you have tough jobs ahead of you, particularly you, Fred, in these times of high interest rates and the housing industry and such declining. You are doing a good job in maintaining what employment level you can. It is tough enough with Plum Creek. Bruce, too, I know the tough job you have managing mineral parts of the company. I think it is unlikely Congress is going to repeal the 2c prohibition on railroad leasing. I appreciate your company's efforts to export products, too. I think that is very important not only to our State but to the country generally as we enter new economic times down the road.

I appreciate your testimony. Again, Dick, thanks for coming.

I will submit additional questions in writing that you can then respond to in writing.

Mr. **Bressler**. We appreciate your interest, Senator.

Senator **Baucus**. Without objection, that will be made a part of the record.

The hearing will now recess for lunch until 1:15.

[Whereupon, at 12:30 p.m., the committee recessed, to reconvene later the same day.]

AFTERNOON SESSION

[Whereupon, at 1:20 p.m., the subcommittee resumed, Senator Max Baucus, chairman of the subcommittee, presiding.]

Senator **Baucus**. The hearing will come to order.

Our next witness is Dr. Ed Sattler, assistant professor, department of economics, Bradley University.

Dr. Sattler, we appreciate the time you have taken to come and help us this afternoon. Please proceed in any manner you wish.

STATEMENT OF DR. EDWARD L. SATTLER, ASSISTANT PROFESSOR, DEPARTMENT OF ECONOMICS, BRADLEY UNIVERSITY

Dr. **Sattler**. I would like to first thank the committee for inviting me to appear today on what I feel is a very important matter.

I would like to speak specifically to the question of the formation of a holding company and its potential impact upon the railroad subsidiary. Mr. Bressler, in the Annual Report for Burlington Northern, Inc., 1980, noted that the holding company would allow the Burlington Northern holding company to provide greater objectivity in future decisionmaking. I think this is a very honest statement, that the holding company provides a means for the Burlington Northern to increase its earnings, possibly in spite of the railroad. I will expand on these comments a little later. The annual report further states that, "While the corporate rate of return on equity has improved to 9.7 percent in 1980, the cost of capital is from 12 to 15 percent" and that 9.7 percent, by the way, includes the railroad and all of the other activities. Historically, the railroad rates of return on equity have been well below the 9.7 percent.

Mr. Bressler further noted that there are two short-term goals for the holding company, and he expanded on these this morning. The first is to improve the efficiency and financial health of the railroad; the second is to expand investments in resource activities so that a better balance is achieved between transportation and resource activities.

At this point, I think it would be a good idea to review the history of the holding company movement, to see how the Burlington Northern fits into the holding company movement.

The holding company movement is a rather recent phenomenon which was initiated in 1960, when the Interstate Commerce Commission first ruled that it lacked jurisdiction over the holding company. Between 1960 and the early 1970's, the majority of class I railroads moved into holding companies. The holding company became generic to the railroad industry, I maintain, because it provided a vehicle for achieving diversification without Interstate Commerce Commission approval. The basic motivation that drove the majority of the railroad industry into diversification had its origin in the regulated nature of the industry and the low rate of return on railroad assets. The railroad responded to this low rate of return by forming a holding company to allow them to pursue other lines of business. This is known as defensive diversification in the literature, or a defensive conglomerate, where the firm moves from their basic industry into other, unrelated industries, because of either real or imagined declining opportunities for a relatively poor current position in their primary industry.

Once the railroad is included in the holding company, it competes with the other subsidiaries for capital. I appreciated Mr. Bressler's comment this morning, as he noted that the Burlington Northern Railroad is currently doing a good job—and I quote him—"of competing with other divisions for capital". He put the emphasis on the fact that the Burlington Northern was currently successful in competing for capital. I would put the emphasis on the fact that he acknowledged that Burlington Northern Railroad does in fact compete with the other divisions for capital. And I would like you to keep that in mind in my later remarks. It is very important to the theory that I will develop.

Joel Dean, in an investigation of conglomerate corporations, stated:

> A conglomerate—and this is a corporation with a lot of different divisions in different industries—is an efficient mechanism, both for milking an obsolescent operation and flowing its cash earnings to investment in more promising divisions and for liquidating an obsolescent operation.

The Interstate Commerce Commission, in a preliminary report in 1969 and in a later report in 1977, noted that, as has already been suggested this morning, there was concern over the possible transfer of funds from the railroad to other subsidiaries or to the parent holding company. Such transfers have escaped the regulatory overview of the Interstate Commerce Commission and possibly harmed the railroad. The Interstate Commerce Commission further suggests that the two most likely avenues suggested for this disinvestment are undermaintenance of track and excessive dividends paid to the parent holding company.

Given all of this background, since I am an economist, I thought it would be interesting to develop a model to try to explain the behavior of the firm. Economics is nothing more than a series of models explaining the behavior of firms and consumers, not always terribly successful in predicting, but it generally does a pretty good job at analyzing. We are not so good at predicting, because there are so many variables that enter into the predictions.

With respect to the holding company model, I think we can break a holding company down into a fairly straight-forward analysis—namely, once a holding company is formed, all of the divisions in the holding company can be looked at as sort of a portfolio, much as an individual might have a portfolio of stocks and bonds, and the holding company then can direct funds to those parts of their portfolio that have the highest profit potential.

I would like to emphasize that prior to the formation of the holding company, the stockholders of the railroad had the primary interest in maintaining the railroad, the financial health of the railroad. Once the holding company is formed, the stockholders of the holding company now have as their primary interest the financial health of the holding company, and the railroad becomes a secondary interest. The holding company management has to recognize this situation.

What I propose in my model is, given this portfolio approach, the holding company would review all of its divisions by comparing profit potential in all of the divisions and they would measure the rate of return, either in equity or assets, for each division and then direct funds to those divisions that are most profitable. They would freeze funds, or in fact, divert funds, from those divisions that are least profitable.

Given this model, the railroads appear to be in a rather unenviable position because of their relatively low rate of return, both in terms of equity and assets in the last several decades.

I do have a couple of qualifications to this fairly straightforward model that looks at profit differential, or as I will call it, profit gap between the railroad and the other divisions. One qualification involves risk. When we look at rate of return figures, we typically do not include risk in the figures. I would argue that when you have relatively low rates of return, if they are stable and if you can depend on the low rates of return, they may be more profitable on a risk-adjusted basis to an industry compared with high rates of return that are very volatile. If the railroad industry, although unprofitable, is not risky, the holding company may prefer to maintain that railroad in spite of a profit gap between the railroad and the alternative investment.

Very quickly, two other qualifications. There is a significant cost of liquidating or divesting the railroad, particularly with a tremendous amount of fixed, specialized capital in the railroad, and so the company may maintain the railroad even though it is not generating nearly as much profit as the alternatives; and third, there may be a complementary relationship between the natural resource divisions and the railroad—namely, the railroad can ship the products of the natural resource divisions over the railroad.

Thus, I would suggest there is some profit gap that the holding company would tolerate between the railroad and its alternative investments, and as this gap gets larger and larger, the incentive to undermaintain the railroad and to divest the railroad gets greater and greater. I have studied a number of railroads that have gone into holding companies and have discovered what I consider to be a causal relationship—namely, those railroads that are relatively unprofitable going into holding companies tend to deteriorate after they go into the holding company. Those railroads that are very profitable or are above average in profitability tend to maintain their efficiency and financial operating characteristics in spite of the holding, or maybe because of the holding company.

This finding provides some guidelines for the type of policy we should recommend.

First, a few specific characteristics about the Burlington Northern. I would agree with testimony this morning that Burlington Northern has been improving recently in terms of profits. It has consistently been above the overall average for U.S. railroads, but below the average for the western roads. Its operating ratio, which is a measure of efficiency, is not very good at all—in fact, it is worse than the rest of the western railroads, but it has been improving slightly. To the Burlington Northern's credit, they do have a fairly good maintenance policy for maintaining track.

I would not classify the Burlington Northern as a weak railroad at this point, and therefore, I do not see in the short term any concern over the Burlington Northern and this holding company. But in the next 5 or 10 years, it is very possible that the optimism for the railroad industry that is currently felt by a number of people could turn out to be incorrect; the railroad earnings could fall. If the holding company pursues its diversification of financial resources, as it argues it is going to do, this would produce a tremendous profit gap which would provide the incentive for the holding company to divest itself of the railroad eventually, or at least lead to deterioration of the railroad.

I would recommend that the Interstate Commerce Commission more closely monitor these holding companies with respect to the transactions with railroad divisions and they more closely analyze what is happening to the specific railroad divisions. In the case of the Burlington Northern, I think the potential exists in the next 5 to 10 years, given the right scenario, for the Burlington Northern Railroad to be harmed by the holding company. If, in fact, the railroad turns out to be improving in profitability all those years, then I would have little concern for the Burlington Northern Railroad.

Senator BAUCUS. Thank you, Dr. Sattler.

[The following was received for the record:]

Statement by Edward L. Sattler

Introduction

The Burlington Northern Railroad recently formed a holding company, Burlington Northern Inc. Typically, the stockholders of the railroad exchange their shares of the old company for the new holding company shares. The railroad then becomes a subsidiary within the context of the holding company. In the Burlington Northern's case, the railroad will be one of eight independent operating companies with each company operating as a separate profit center.

As stated in the Burlington Northern's Annual Report for 1980, the holding company will allow for "greater objectivity in future decision making".[1] This straightforward statement appears to imply that funds should be allocated to the subsidiaries based on the rate of return each subsidiary is generating. The annual report further states that while the corporate return on equity has improved to 9.7% in 1980, because the cost of capital is from 12% to 15%, the return on equity for all divisions is inadequate.[2] The return includes the railroad and all subsidiaries. Historically railroad rates of return in equity have been below the 9.7% level.

The Annual Report for 1980 also notes that the holding company structure will allow for the company to issue securities for non-transportation acquisitions.[3] This combination of relatively low rate of return for the railroad, a profit center organizational structure where the railroad must compete with other divisions for funds, and the increased capability to acquire non-transportation investments has raised some legitimate concern about the long term impacts of the holding company on the railroad.

It should be noted that Richard M. Bressler, President and Chief Executive Officer of Burlington Northern Inc., has expressed optimism about the profit potential of the railroad. He has also indicated that acquisitions in the future would most likely be in addition to the existing business.[4] The stated policy in the Annual Report for 1981 is that two short run goals predominate. The first is to improve the efficiency and financial health of the railroad. The second is to expand investments in the resource activities so that a better balance is achieved between the transportation and resource activities.[5]

At this time it is not clear that these two short term goals are consistent. Without questioning Mr. Bressler's sincerity, this would not be the first time the chief executive officer of a newly formed holding company has pledged an upgrading of a railroad and not followed through over the long term.

In order to view the Burlington Northern holding company in perspective it is appropriate to examine the holding company movement in the railroad industry over the past twenty years. A brief history of the holding company movement will be followed by a review of the motivation for forming holding companies and some of the reasons for concern. Next, a theory of the holding company phenomenon in the railroad industry will be advanced followed by an analysis of railroad holding companies and a conclusion for the general phenomenon. The Burlington Northern will then be analyzed within the context of the overall holding company movement.

Holding Company Review

In 1960, the Interstate Commerce Commission (ICC) ruled that it lacked jurisdiction over holding companies formed by railroads.[6] This development allowed the holding company to pursue a diversification strategy that probably would have been denied authorization by the ICC had the railroad tried to diversify by issuing stock or guaranteeing debt securities.[7] The majority of Class I railroads formed holding companies in the next decade with two time periods, 1960 to 1962 and 1967 to 1970, witnessing most of the holding company formation activity.

The holding company became generic to the railroad industry because it provided a vehicle for achieving diversification without ICC approval. The basic motivation that drove the majority of the railroad industry into diversification had its origin in the regulated nature of the industry and the low rate of return in railroad assets. Responding to the low rates of return in the railroad industry, the railroad holding companies allow the new company to diversify into alternative lines of business that provide much higher rates of return than the railroad. This type of diversification has been referred to as a "defensive conglomerate" as the firm moves from their basic industry into other unrelated industries because of either real or imagined declining opportunities or a relatively poor current position in their primary industry.[8]

Once the railroad becomes part of a holding company structure with other divisions and products, the effect on the railroad, both operationally and financially, can be significant. The holding company becomes, in effect, a multi-product firm with all of the divisions, including the railroad, competing with each other for capital.

The railroad subsidiary effectively competes against the non-regulated subsidiaries on a rate of return basis. The main obligation of those in charge of the parent holding company is to their stockholders in maximizing the overall rate of return. Prior to the formation of the holding company the stockholders of the railroad and the regulatory agency had a common objective, namely the financial integrity of that firm. Once the holding company is formed, the interests of the stockholders of the new parent company rest with the financial integrity of the holding company. The health of any of the subsidiaries becomes secondary and could be sacrificed if needed for the health of the parent company.

Placing the railroad in a position of competing for funds portends a pessimistic outlook if the rate of return in the railroad industry is significantly lower than in the nonregulated industries in which the parent company invests. The rational manager of the parent company would cut back operations in the less profitable subsidiaries and expand in the more profitable subsidiaries. This policy of allocating funds to the most profitable subsidiaries is in concert with the stockholders of the parent company but not necessarily with the regulatory agency and the public interest for the regulated firm. The public interest for the firm is defined as maintaining an adequate level of performance in terms of financial and operating variables.

If funds are not allocated to the regulated firm by the holding company, both of these variables could suffer.

There is the possibility of one of the subsidiaries of a holding company cross subsidizing another subsidiary for the short term.[9] Conceivably, in the short run, the parent might use earnings from the more profitable subsidiaries to strengthen the regulated firm, but if the firm did not improve in the long run, disinvestment would be inevitable. However, Joel Dean in An Investigation of Conglomerate Corporations stated that the conglomerate is an "efficient mechanism both for milking an obsolescent operation and flowing its cash earnings to investment in more promising divisions and for liquidating the obsolescent operation.[10]

The Interstate Commerce Commission, in reports issued in 1969 and 1977, has expressed concern over the financial and operating integrity of transportation firms that enter holding companies. The ICC was particularly concerned over the possible transfer of funds from the railroad to other subsidiaries or to the parent holding company.[11] Such transfers would escape the regulatory overview of the ICC and possibly harm the railroad.

If the holding company did decide to divest itself of the railroad, the two most likely avenues for divestment suggested by the ICC were undermaintenance of track and excessive dividends paid to the parent holding company by the railroad.[12] It should be noted that the holding company could also benefit a railroad by providing easier access to capital, attracting better management, and stabilizing the flow of earnings.

Holding Company Model

In spite of the concern by many about the possible detrimental effects on the railroad as a result of the holding company movement, it is not at all clear that the railroad will definitely suffer once it becomes a subsidiary within a holding company. A theoretical model has been developed which provides some assistance in predicting those instances where the holding company would benefit the railroad and other cases where the railroad would be harmed.

The model assumes that the holding companies will pursue profit maximization and treat all of the subsidiaries as if they were elements of a portfolio allocating funds to each subsidiary or division on the basis of rate-of-return. Those subsidiaries experiencing higher rates of return will receive more funds from the holding company while those with a low rate of return will receive less funding. If the rate-of-return in a subsidiary continues to be below that available in alternative investments, the holding company will take funds away in the long run and eventually divest itself of that subsidiary.

Because funds are allocated within the holding company on the basis of profitability of the divisions, one would expect the profitability of the railroad to affect the extent of diversification. The holding company, using a portfolio approach, would presumably compare the profitability of alternative investments to that of the railroad. The extent of diversification would therefore be a function of the rate of return on the railroad and the rate of return on alternative investments. The more successful the alternative investments, the greater the gap in earnings and the more likely that the holding company would pursue an active diversification program, possibly at the expense of the railroad.

The central hypothesis of this model is that the size of the profit gap between the rate of return on the railroad and the rate of return on alternative investments will affect the degree of diversification pursued by the holding company. Using the portfolio approach, the more profitable railroads would likely experience a smaller profit gap, resulting in a limited diversification program into alternative investments. Following the same logic, the less prosperous railroads would be more likely to diversify into more profitable industries. The less profitable the railroad, the more likely that the profit gap would be large, providing a strong incentive to diversify into the more profitable investment.

Three qualifications to the above argument might result in the holding company tolerating a long term "profit gap" between the subsidiary losing money or receiving a lower rate-of-return compared to alternative investments. The first qualification pertains to the amount of risk involved in a business venture. Combining the risk factor with the expected rate-of-return to derive the risk-adjusted rate-of-return gives a more appropriate measure of the validity of a subsidiary in any corporation's capital budgeting process. An investment with a high rate-of-return and a high risk factor (variability of earnings) may produce a lower risk adjusted rate-of-return than a stable flow of lower earnings. The railroad may appear to have a lower rate-of-return as reported in the financial statement, but the risk adjusted rate-of-return may in fact be higher than more risky alternatives.

Another qualification to the straight portfolio approach of the holding company comparing rates-of-return of the divisions is the cost of liquidation or divesting the division may be substantial. This is particularly relevant if the firm has a large stock of fixed capital that is durable and very specialized as in the case of railroads. The final qualification which might result in the holding company tolerating a profit gap is if the subsidiaries are complementary in nature. The railroad's land and natural resource divisions may be complemented by the railroad hauling the resources to market.

Thus, the risk differential, cost of liquidation, and complementary relationship of the regulated firm to other divisions all offer the possibility that the holding company would consider maintaining the railroad division (lower profit) in the long run despite a gap in earnings between the lower profit division and alternative investments.

It is not clear at what point the size of the gap in rates of return would begin to affect the railroad adversely. That critical level might vary with the differing circumstances of the holding companies. The size of the gap in earnings is a matter of degree; the likelihood that the railroad would be injured increases as the gap increases and as the amount of diversification increases. Thus, assuming that two holding companies could earn the same rate of return on alternative investments, and further, that one of the companies had a railroad subsidiary that was fairly prosperous for the industry while the other company has a relatively unprofitable railroad, the gap in prospective earnings would be larger in the latter case and the incentive for the holding company to divest itself of the railroad in the long run would be stronger.

Even the relatively prosperous railroads could suffer if the holding companies objectively compared rates of return and allocated funds to the divisions with the highest returns. The most prosperous roads have rate of return of only about eight percent, relatively low when compared to other industries.[13]

Even in the case of the holding company with the relatively unprofitable railroad, a rational short-run strategy might be to hold on to the railroad and allow it to generate cash flow needed for diversification, and tax loss carry-forwards to reduce the holding company's tax bill. But even in this case, the holding company might allow the railroad to deteriorate in service in the long run.

Holding Company Experience

Five of the sixteen Class I railroads that were studied deteriorated in financial and operating performance after formation of the holding company and four of the five railroads were among the least profitable of the sixteen.[14] The four railroads included the Chicago and Northwestern, the Chicago, Milwaukee, St. Paul, and Pacific, the Western Pacific, and the Missouri-Kansas-Texas. The one profitable railroad in the five, the Illinois Central Gulf, significantly deteriorated in performance after 1970 (it formed the

Illinois Central Industries holding company in 1962), once the the diversification program became significant. Only the Missouri-Kansas-Texas Railroad from the five has escaped bankruptcy, divesture, or attempts to divest the railroad.

Those railroads that were relatively profitable going into the holding company tended to maintain or improve their performance. Thus, the profit gap explanation seems to have some power in predicting the impact of the holding company on the regulated firm, in this case the railroad. Fears of excessive disinvestment and deteriorated performance for holding company railroads appear to be justified only for those railroads that were unprofitable going into the holding company where the profit gap between the railroad and alternative investments was large. Those holding companies were aggressively diversified to the detriment of the railroad.

In those instances where the railroad was relatively profitable, the holding company provided the means for diversifying into other, in many cases, unrelated, industries while the railroad did not suffer. In fact, two profitable railroads, the Atchison Topeka and Santa Fe and the Denver Rio Grande and Western actually improved in performance after the formation of the holding company.

Conclusion and General Policy Recommendation

The model proposed in this paper defined railroads on the basis of profitability and the expected profit gap between the railroad and alternative investments within the holding company. The larger the profit gap, the more diversification was expected. As the railroad became relatively less important in the holding company, deteriorated performance and eventual disinvestment of the railroad were predicted.

The results indicate that those railroads that were least profitable, and therefore had a large profit gap between rates of return from alternative investments and those from railroad investments, diversified heavily until the railroad became a relatively minor part of the holding company operation. The fear of excess disinvestment and deteriorated performance for holding company railroads appeared to be justified only for those railroads that were weak in financial and operating terms at the time the holding company was formed.

Most of the holding company railroads exhibited no change, or improved in performance after the formation of the holding company. This indicates that the holding company itself was not necessarily a detrimental development in the railroad industry. One could argue that the most inefficient and poorest railroads could be expected to deteriorate in terms of relative performance whether or not the holding company was formed. This may be true, but the holding company appears not to have been the source of salvation for poor railroads that many holding company proponents have argued it would be.

This investigation revealed that the holding company device has had little impact on healthy railroads but may have accelerated a deterioration in the performance of those roads that were weak prior to the formation of the holding company. Disinvestment appears to have been the ultimate objective for the weaker roads.

When railroads initially formed holding companies, there was widespread concern that the performance of the railroad would deteriorate, using the holding company as the vehicle for disinvestment. Similar fears have been expressed about other regulated firms that have formed holding companies in trucking, the airlines, and public utilities. The results of this investigation indicate that a general concern for deteriorated performance in the regulated firms is not warranted. However, the relationship between the regulated firm and the holding company should be monitored, with special concern for those regulated firms that were in the most questionable or poorest financial condition before the formation of the holding company.

The Burlington Northern and the Model

The Burlington Northern Railroad appears to be neither a strong nor a weak railroad in terms of financial or operating performance. The Burlington Northern Railroad (BN) has experienced a return on investment the past six years which has consistently been above the average for all railroads in the country and consistently below the average for railroads in the Western District of the United States.[15]

The BN has an operating ratio which is worse than most of the other western railroads, although it has been improving the last two years. An interesting measure of the maintenance of track policy for the railroad is the maintenance expenditures over the operating revenues. The BN has had a maintenance to operating revenue ratio that is well above the average for the other western railroads.

At this point in time, the BN does not appear to qualify as a weak railroad that could be threatened in the near future by inclusion into a holding company arrangement. However, this situation could change in the future if some of the optimism for the railroad that has been expressed by holding company officials is misplaced and if the intended expansion of the natural resource divisions is very profitable. The earnings gap that was noted earlier could increase with potential detrimental impacts for the railroad.

Even without a holding company structure, the BN increased the share of the natural resource activities from 7% of operating revenues and sales in 1975 to 9% in 1978 and in 1981 it fell to 8.4%. Meanwhile, during that same time period the railroad's share of operating revenues and sales fell from 88% in 1975 to 84% in 1978 ad to 83% in 1981. The stated goal of the holding company management is to increase the natural resource divisions to attain a better "balance".[16]

In spite of the relatively low revenue contributions of the natural resource businesses, they contributed 39% of the net operating income in 1975, 50% in 1978, and 23% in 1981. The percentage of contribution to net operating income was lower in 1981 because railroad earnings increased significantly in that year. However, the natural resource divisions, which contributed an 8.4% of the operating revenues in 1981 contributed almost three times as much, in terms of percentage, of the net operating income. The motivation for the holding company to expand the natural resource activities is understandable.

Finally, in 1981 the holding company increased capital expenditures to $398 million from $387 million in 1980. However, capital expenditures for the railroad fell from $335 million in 1980 to $298 million in 1981. The railroad accounted for 87% of the total capital expenditures in 1980 and only 75% in 1981. Meanwhile, the natural resource division's share increased from 10% of capital expenditures in 1980 to 21% in 1981.[17] This development, although not threatening to the railroad now, could potentially harm it in the future if it becomes a long-term trend.

Recent changes in tax laws allow for faster depreciation over a shorter time period generating significant gains in cash flows for the railroad. Whether these excess cash flows are used for the benefit of the railroad or to finance further development of natural resource divisions in part depends on the previously mentioned earnings gap and cannot be answered now.

Recommendations

Consistent with my prior conclusions about railroad holding companies in general, I believe that the Interstate Commerce Commission should monitor the activities of the holding companies, particularly those holding companies that have a weak railroad subsidiary.

The Burlington Northern Railroad does not appear to be threatened by Burlington Northern Inc. in the short run, but in the long run the potential for a detrimental impact on the railroad clearly exists.

FOOTNOTES

[1] Burlington Northern Inc., Annual Report 1980, (Seattle, Washington, 1981), p. 2.

[2] Ibid, p. 2.

[3] Ibid, p. 2.

[4] Ibid, p. 1.

[5] Burlington Northern Inc., Annual Report 1981, (Seattle, Washington, 1982), p. 3.

[6] Colin Barrett, "Conglomerates and Public Responsibility," in Penn Central and Other Railroads (Washington, D.C.: U.S. Senate Committee on Commerce, 1970), p. 568.

[7] Ibid, p. 567.

[8] Samuel Reid, Mergers, Managers, and the Economy, (New York: McGraw Hill, 1968), p. 195.

[9] George Eads, "Railroad Diversification: Where Lies the Public Interest?" Bell Journal, 1974, p. 600.

[10] Joel Dean, Some Causes and Consequences of Conglomerate Mergers, An Investigation of Conglomerate Corporations (Washington, D.C.: U.S. Committee on the Judiciary), p. 323.

[11] U.S. Interstate Commerce Commission *Conglomerate Merger Studies* (Washington, D.C.: Government Printing Office, 1977), pp. 9-45.

[12] U.S. Interstate Commerce Commission *Conglomerate Merger Studies* (Washington, D.C.: Government Printing Office, 1970), p. 123.

[13] Task Force on Railroad Productivity, *Improving Railroad Productivity* (Washington, D.C.: U.S. Government Printing Office, 1977), p. 85.

[14] Edward L. Sattler, "Diversified Holding Companies and Their Impact on the Railroad Industry," *The Transportation Journal*, Fall 1980, p. 73.

[15] Association of American Railroads, *Property Investment and Condensed Income Statement in Class I Railroads*, 1975-1980.

[16] Burlington Northern Inc., *Annual Report 1981*, (Seattle, Washington, 1982), p. 3.

[17] Ibid, p. 22.

DIVERSIFIED HOLDING COMPANIES AND THEIR IMPACT ON THE RAILROAD INDUSTRY

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BACKGROUND

In 1960, the Bangor and Aroostook, a small Class I railroad (Class I railroads are now defined as those with operating revenues of $50,000,000 or more) successfully diversified by forming a holding company, the Bangor Punta Corporation. The railroad could have diversified into non-railroad businesses only by receiving Interstate Commerce Commission (ICC) authorization for issuing railroad stock or issuing or guaranteeing debt securities. Until the 1960's, the ICC approved only very limited diversification by the railroads. The ICC was wary about railroads diversifying and probably would have denied authorization.[1] However, the ICC ruled that because the parent company, the Bangor Punta Corporation, was not a railroad, the commission had no jurisdiction.[2]

Once the ICC ruled a lack of jurisdiction over holding companies, most of the Class I railroads followed the lead of the Bangor and Aroostook creating a parent holding company and then asking shareholders to voluntarily change their shares to those of the newly created corporation. By 1974, nearly 70 percent (in terms of assets) of the Class I railroads were controlled by holding companies.[3] Several formed their holding companies in 1962 and most of the railroads went into holding companies in 1968. The railroads that formed holding companies include railroads from all sections of the country and companies in poor as well as good financial condition.

The holding company became generic to the railroad industry because it provided the vehicle for achieving diversification without ICC approval. The basic motivation that drove the majority of the railroad industry into diversification had its origin in the regulated nature of the industry and the low rates of return. The purpose of this study was to identify characteristics of holding companies created by railroads and determine the impact of those characteristics on the extent of diversification as well as the impact on the railroad subsidiary.

The creation of a holding company to diversify into unregulated industries raises questions for regulated industries because of the dualistic status of the regulated industries. Regulated firms are businesses with the objective of making a profit like other businesses, but they are also public utilities, charged with maintaining a reasonable level of service at regulated rates. If their venture into a new field threatens their provision of the public service, then the regulatory agency concerned has a legitimate interest in questioning the venture.

Most of the literature on conglomerates (diversified holding companies) deals with trying to access whether the conglomerate is a profit maximizer or a growth maximizer. Little attention has been paid to the probable impact on specific divisions within a holding company framework. Williamson has addressed the question of the impact of a holding company structure on the overall performance of the divisions. He argues that a multiproduct firm organized along product division lines is more efficient than one organized by functions.[4] The profit center concept by product line would result in superior performance in the multiproduct firm more in line with a cost minimizing and profit maximizing firm.

Bank holding companies have been studied in terms of the impact on the performance of the banks that have diversified into nonbanking activities.[5] The Interstate Commerce Commission has examined the impact of railroad holding companies in terms of intracompany transactions between the holding company and the railroad.[6]

HOLDING COMPANY MODEL

Holding Company Characteristics

Although a number of specific motives have been suggested as spurring the holding company movement in the railroad industry, the basic underlying motive was to avoid ICC regulations on non-railroad business and increase the rate-of-return. Creating a separate corporate entity, the holding company, was the only effective way to accomplish this objective.

The railroads that formed holding companies fall, for the most part, into two basic groups. One group consists of the more prosperous roads within the railroad industry -- those roads with rates of return between three and eight percent. The second group consists of poorer roads which consist of those roads with rates of return of two percent or less. This breakdown roughly divides the railroads according to financial health and operating efficiency with those railroads above three percent generally being more healthy financially and more efficient in operating terms.

Included within each of these groups are two subgroups. The first subgroup includes railroads that own substantial non-rail assets such as trucking, real estate, and natural resources. The second subgroup owns little or no non-rail assets. The classification of either a group one or group two railroad by subgroup will impact on the strategy of diversification, not the extent of diversification.

Holding companies formed by both basic groups are assumed to have the same objective function, namely profit maximization, and treat all of their subsidiaries as if they were elements of a portfolio. Funds would then be allocated to each subsidiary or division on the basis of the rate-of-return. However, the amount of diversification and the strategy followed in establishing divisions within the holding companies can be expected to vary.

Because funds are allocated within the holding company on the basis of profitability of the divisions, one would expect the profitability of the railroad to affect the extent of diversification. The holding company, using a portfolio approach, would presumably be comparing the profitability of the railroad with profitability in alternative investments. Therefore, the extent of diversification would be a function of the rate-of-return on the railroad and the rate-of-return on alternative investments. The more successful the alternative investments, the greater the gap in earnings and the more likely the holding company would pursue an active diversification program, possibly at the expense of the railroad.

The central hypothesis of this study is that the size of the profit gap between the rate of return on the railroad and the rate of return on alternative investments will affect the degree of diversification pursued by the holding company. Using the portfolio approach, the more profitable railroads would likely experience a smaller profit gap resulting in a limited diversification program into alternative investments. Following the same logic, the less prosperous railroads would be more likely to actively diversify into more profitable industries. The less profitable the railroad, the more likely the profit gap would be large, providing a strong incentive to diversify into the more profitable investment.

As a corollary to the above argument, the more a holding company moves into new fields in investment and the larger the profit gap, the more likely the railroad will suffer in terms of undermaintenance and deteriorating performance. A large profit gap along with extensive diversification would likely result in the holding company allocating funds away from the railroad resulting in deteriorated performance for the railroad.

An additional hypothesis relates to the strategy of diversification reflected by the areas into which the holding company diversifies. Traditionally, the railroads have owned natural resources, real estate, and other transportation activities. The more non-rail assets owned by the railroad at the time the holding company is formed, the more likely the holding company will limit diversification to removing those assets from the railroad. The motivation to remove the non-rail assets from the railroad results from a desire to free the management of those assets from any Interstate Commerce Commission supervision or restrictions. The ICC no longer has authority over those assets once they become another subsidiary within the holding company. Therefore, one would expect the holding company formed by a railroad to diversify less into manufacturing industries and simply spin off the non-rail assets into other subsidiaries within the holding company.

When the railroad within the holding company combines the characteristics of being relatively poor and owning few non-rail assets, one would expect active diversification mainly into manufacturing industries. The relatively prosperous railroads with few non-rail assets would likely pursue limited diversification into manufacturing industries. Finally, the relatively prosperous railroads with non-rail assets would likely follow limited diversification mainly by spinning off their traditional non-rail assets as separate companies within the holding company.

Thus, there are two groups of holding companies that differ only in the circumstances surrounding the initial formation of the holding company. Both groups of holding companies could potentially benefit from lower capital cost, better use of internal capital, and improved management. However, the important question regarding the impact of the holding company on the railroad remains to be answered.

Qualification to the Portfolio Approach

Even the relatively prosperous railroads would suffer if the holding companies rationally compared rates-of-return and allocated funds to the divisions with the highest returns. The most prosperous roads have rates-of-return of only about eight percent, relatively low when compared to other industries.[7] Two qualifications to a straight portfolio rate-of-return comparison are assumed. One is the risks involved or associated with the rate-of-return and the second is the cost of liquidating the railroad.

The amount of risk involved in a business venture should be combined with the expected rate-of-return to derive a risk-adjusted rate-of-return. The risk factor, as measured by the variability of prospective earnings, is an integral part of any corporation's capital budgeting process. The past three decades have found the railroads to have more earnings fluctuation and lower rates of return on capital investment than the regulated utilities such as the gas, water, electric, and telephone utilities.[8] However, the risk factor for the low level of return for the railroads may be lower than the risk associated with more profitable new lines of industry that the holding company could pursue. If that were true, an examination only of the rates of return would leave out an element of the decision-making process. One could imagine circumstances where the risk-adjusted rate of return of the railroad would be closer to the risk-adjusted rate of return for alternative investments. This would be especially true if the railroad had a history of admittedly low but stable earnings compared to a new industry in which the holding company had little experience.

Another qualification to the straight portfolio approach of the holding company comparing rates of return of the divisions is that the cost of liquidating or dumping the railroad may well be substantial. The railroad has a very large stock of fixed capital that is durable and very specialized. Therefore, the holding company might have a second reason to tolerate a gap between the earnings of the railroad and alternative investments in the long run. In addition to the cost of liquidation, even a relatively unprofitable railroad generates a sizeable cash flow which can be used by the holding company. Finally, some of the land and natural resource divisions in the group one holding company could find a very complementary relationship between the railroad and land values or hauling the resources to market.

Thus, the risk differential, cost of liquidation, and complementary relationship of the railroad to other divisions all offer the possibility that the holding company would consider maintaining the railroad division in the long run despite a gap in earnings between the railroad and alternative investments.

It is not clear at what point the size of the gap in rates of return would begin to adversely affect the railroad. That critical level of a tolerable gap in earnings might vary with the differing circumstances of the holding companies. What can be said about the size of the gap in earnings is that it is a matter of degree and the likelihood that the railroad would be injured increases as the gap increases and the amount of diversification increases. Thus, assuming that two holding companies could earn the same rate of return on alternative investments and one of the companies had a railroad subsidiary that was fairly prosperous for the industry while the other company had a relatively unprofitable railroad, the gap in prospective earnings would be larger in the latter case and the incentive for the holding company to divest itself of the railroad in the long run would be stronger.

Even in the case of the holding company with the relatively unprofitable railroad, a rational short-run strategy might be to hold on to the railroad and allow it to generate cash flow needed for diversification and tax loss carry-forwards to reduce the holding company's tax bill. But even in this case, the holding company would very likely allow the railroad to deteriorate in service in the long run.

In summary, two general categories of railroad holding companies should emerge in the analysis -- those with profitable roads and those with unprofitable roads. Profit maximization is assumed to be the common objective function, but the extent of diversification and the particular strategies of diversification could vary because of the different original conditions of the respective railroads. Each holding company, it is assumed, will tolerate a gap in earnings between the railroad and alternative investments; but as the gap grows, the incentive to diversify and eventually disinvest the railroad will become stronger.

IMPACT ON RAILROADS

The main interest in this study is the impact that the holding company framework has on the performance of the railroad. This is the essential public policy question and is also applicable to the holding company phenomenon in other regulated industries such as banking, utilities, the airlines, and trucking. The basic question is the nature of the impact on the regulated firm whose rate of return is directly or indirectly controlled when it must compete with other, mostly unregulated, industries for capital.

This study has advanced the theory of two different categories of holding companies, each having its attitude toward the railroad determined by the gap in earnings between the profitability of alternative ventures and the railroad's profitability. Since the size of the gap assumes a critical importance for the long-term viability of the railroad, the fate of the railroad depends not only on its own profitability but on the profitability of alternative investments. One would expect the alternative investments to vary in profitability from one holding company to another depending on the success of their diversification efforts.

Some disinvestment in the railroads is appropriate with the excess capacity present under ICC regulations. The concern is not whether some disinvestment in the railroad occurs but whether it proceeds in a fashion injurious to the performance of the railroad. Performance is reflected by variables representing efficiency, liquidity, and solvency with particular emphasis on efficiency. As long as the gap in earnings is not too large, the holding company can be expected to maintain the performance standards of the railroad because of its interest in maintaining the railroad in the long run. Even if the holding company decides to disinvest some of the railroad to reduce excess capacity, it could maintain the performance of the railroad. Once the earnings gap becomes large enough for the holding company to question the long-term viability of the railroad, one would expect more massive disinvestment with harmful consequences to the railroad's performance. Two of the most likely avenues for disinvestment out of the railroad were suggested by the ICC to be undermaintenance of track and excessive dividends paid to the parent holding company.[9] Both of these practices can be examined with information supplied to the ICC.

METHOD

The basic approach in this study was to compare railroads by using key variables of performance. The interesting hypothesis tested was whether the formation of a railroad holding company had a significant effect that was reflected in a deteriorated performance of the railroad. A comparison of pre-holding company and post-holding company averages allowed for an examination of comparative performance and revealed trends and changes in trends of performance.

The performance variables included operating efficiency measures such as the operating ratio, transportation ratio, gross-ton-miles per train hour, maintenance expenditures over operating revenues, and rate of return. Financial variables include cash over current liabilities, current assets over current liabilities, fixed charges over earnings, and dividends over earnings.

In an industry as complex as railroads, one must be especially aware of the problem of "exogenous" influences that affect the behavior of the firms. To control for the different cost functions and operating characteristics of small and large railroads, the railroads were grouped on the basis of size or number of line miles. Railroads were also compared only if they were in the same geographical area of the country. This is particularly important in controlling for weather and its effect on operations and the need for maintenance expenditures.

Railroads, like most firms, are greatly affected by general economic conditions. By examining and comparing the same time period before and after the formation of the holding company, general economic conditions were taken into account, at least in part.

The time periods chosen for a before and after examination should be dictated by performance expectations and the nature of the data. The Department of Transportation study on rationalizing the rail network studied the year before the merger and five years following the merger. The justification behind the one and five year time periods was to give one year of comparison before the merger and then examine the difference in the following period. Five years was chosen because the expected benefits in terms of yard and operation performance measures would occur within five years after merger.[10]

In other studies it is not uncommon to encounter a five year period before merger and five years after the merger year. In the present study there was no specific pre-holding company or post-holding company time period that was suggested by the theory. The prior period should be of sufficient duration to control for differences in trends in the paired firms while the post period should allow the holding company sufficient time to diversify into non-rail activities. In some cases, such as Kansas City Industries, diversification was initiated very quickly while in some other cases, such as Illinois Central Industries, several years passed before any diversification was attempted.[11]

The nature of the data limits the number of post-holding company years that can be studied. It would be preferable to include a ten year period of comparison before and after the holding company. The data are available for ten years prior but in a number of cases the movement into a holding company occurred in the early 1970's; thus not enough time has elapsed for ten years of data after the holding company. Therefore, as a minimum time period defined by the data, a minimum of six prior years and six post years were the appropriate time periods for analysis.

The two critical years that represent the formation of the holding companies were 1962 and 1969. Four holding companies were formed in 1962 or soon after and the 1967-1968 period accounts for the remainder of the holding company railroads except for the Milwaukee Road (1970) and the Western Pacific (1971).[12] In order to group the data into pre and post time periods that would correspond to most of the holding company years and still allow for as much comparison as possible between the railroads, three time periods were chosen as a means of grouping the data for each of the variables.

The first time period includes 1956 through 1962 and provides a seven year period prior to the 1962 holding companies. The 1963 through 1968 time period is six years in length and serves as a post holding company period for the 1962 holding companies and a pre holding company period for the 1968 holding companies. Finally, the 1969 through 1976 time period is eight years in length and serves as a post holding company time period for all the holding companies. All three time periods are of comparable length and provide a consistent method to analyze the impacts of holding companies.

Specific averages for each railroad, both pre and post holding company, were compared against other railroads in the region as well as the average for the group of railroads studied in the region during the relevant time periods. By comparing the pre and post holding company averages with changes in the average for other railroads in the region and changes in the regional average during the pre and post time periods, certain performance variables should reflect a change in policy as a result of the holding company.

RESULTS

The ideal conclusions would include a clear distinction between the performance of the railroads in holding companies and those that did not form holding companies. However, because so few railroads refrained from forming holding companies during the twenty-year period studied, the main conclusions deal with contrasting holding company railroads with each other. Non-holding company railroads are included in that process to serve as points of reference in determining the relative performance of the holding company railroads.

The two models of railroad holding companies discussed earlier presented the railroads on the basis of profitability. Those railroads that had average profits of three percent or above were projected to have a small profit gap with respect to alternative investments and were less likely to actively

Table 1

A key to the railroad abbreviations is included for the conclusions.

KEY TO ABBREVIATIONS

Western Roads more than 5000 miles:		
Chicago, Milwaukee, St. Paul and Pacific	(70)	MILW
Atchison, Topeka, and Santa Fe	(68)	ATSF
Chicago and Northwestern	(67)*	CNW
Southern Pacific	(69)	SP
Missouri Pacific	(62)	MP
Union Pacific	(69)	UP
Chicago, Rock Island, and Pacific	(-)	RI
Western Roads less than 5000 miles:		
Missouri - Kansas - Texas	(67)	MKT
Western Pacific	(71)**	WP
St. Louis - San Francisco	(-)	SLSF
Kansas City Southern	(62)	KCS
Denver and Rio Grande Western	(69)	DRGW
Southern:		
Seaboard Coast Line	(69)	SCL
Illinois Central Gulf	(62)	ICG
Southern	(-)	SOU
Eastern:		
Bangor and Aroostook	(62)***	BAR
Maine Central	(-)	MC
Detroit, Toledo, and Ironton	(-)	DTI

( ) The number in the parenthesis reflects the year that the holding company was formed.

* The holding company sold the railroad in 1972.

** The holding company sold the railroad in 1979.

*** The holding company sold the railroad in 1967.

Table 2: Railroads by Category

Profitable With Non-Rail Assets	Profitable Without Non-Rail-Assets	Unprofitable With Non-Rail Assets	Unprofitable Without Non-Rail Assets
ATSF°	MP	None	CNW*
UP	KCS		MILW*
SP	DRGW°		MKT*
	ICG*		WP*
	SCL		(RI)
	BAR		
	(SLSF)		
	(SOU)		
	(MC)		
	(DTI)		

* Holding company railroads that deteriorated in performance.
° Holding company railroads that improved in performance.
( ) Roads that did not go into holding companies.

Table 3: Comparative Post-Holding Company Rates of Return

Profit Gap	Rate of Return[1]		
	RR	Alt. Investments	Profit Gap
MKT*	-1	18	19
CNW*	2	14	12
WP*	1	13	12
KCS	4	16	12
SCL	4	16	12
ICG*	3	14	11
ATSF°	4	15	11
MILW*	-2	7	9
DRGW°	6	14	8
SP	3	10	7
BAR	3	9	6
MP	5	9	4
UP	7	9	2
SLSF	5	-	
SOU	7	-	
RI	-4	-	
MC	3	-	
DTI	4	-	

[1] Average rates of return after the formation of the holding company.
* Holding company railroads that deteriorated in performance.
° Holding company railroads that improved in performance.

diversify and allow the railroad to deteriorate. Those railroads with average profits of two percent or less were projected to have large profit gaps resulting in active diversification increasing the likelihood of a deterioration in the railroad's performance.

By adding two classifications within each grouping based on ownership of lack thereof of non-rail assets, the strategy of the diversification effort could be predicted. The more non-rail assets owned, the more likely diversification would be limited to spinning-off those assets while those roads with few non-rail assets could be expected to diversify into totally unrelated industries. Using the two general groups, divided further by the ownership of non-rail assets, the following illustrates the railroads in this study classified into the four types discussed above. (See the accompanying tables).

Given the two general groupings of railroads and their predicted behavior, the size of the profit gap between the railroad and alternative investments should be greater as one moves to the right in table 2 providing a greater incentive for the holding company to divest the railroad. The more disinvestment out of the railroad, the more likely that the performance, both operating and financial, should deteriorate.

The earnings gap was generally a function of the initial profitability of the railroad as indicated by the theory. The largest gap between railroad earnings and alternative investment earnings tended to occur in the least profitable railroads. Three of the four railroads in the unprofitable category had the largest gaps in earnings. The next three railroad holding companies listed in order of profit gaps had rates of return of only three to four percent. The smallest profit gaps tended to occur with the most profitable railroads. The relationship between the railroad's holding companies and their profit gaps is not continuous because the gap is partially a function of the holding companies' success in alternative ventures.

The degree of diversification for the holding companies was mainly a function of the earnings gap, as indicated by the theory. The heaviest diversification occurred in the MKT, CNW, and ICG, each of which had rather large profit gaps. The UP and WP experienced moderate to heavy diversification in spite of a rather small profit gap for the UP and a relatively large gap for the WP. This can be partially explained by the large amount of non-rail assets that were previously owned by the UP railroad. The balance of the railroads experienced light to moderate diversification and only the KCS and the SCL of these six roads had large profit gaps.

The theory would lead one to expect those railroad holding companies that diversified the most would allow the railroads performance both operating and financial, to deteriorate. The three roads (CNW, MKT, ICG) that diversified most heavily suffered in terms of performance. The two railroads that diversified to a moderate extent or less and suffered a decline in performance were the MILW, which had a moderate profit gap, and the WP, which experienced a fairly large profit gap.

It is interesting to note that of the five railroads that deteriorated in performance relative to other roads, four were in the unprofitable category: the CNW, MILW, WP, and MKT railroads. The one railroad deteriorating in performance that was located in the profitable category was the ICG after 1970. The ICG was the principal contributor of revenues and profits to Illinois Central Industries until 1970 when the other subsidiaries became more important in both categories.

It therefore appears that the best predictor of deteriorating performance for a railroad is the lack of profitability of the railroad supplemented by the profit gap and resulting diversification. In the case of ICG, as the railroad became less important, the railroad performance deteriorated noticeably. Also, as Western Pacific Industries acquired a manufacturing firm that contributed half of its revenues, the performance of the WP deteriorated. Apparently the relative importance of the railroad in the holding company affects the attitude of the parent company towards the railroad. This negative impact on the railroad of declining relative importance is consistent with the earlier discussion of expecting deteriorating performance as diversification increases.

Only one holding company railroad (the ATSF) clearly improved in performance, while the DRGW showed some improvement. The ATSF and the DRGW were in the profitable category. The three non holding company railroads included the SOU, which improved in performance and the SLSF, which showed no change in performance. Both of these roads were in the profitable category. The RI deteriorated in performance and, like three of the holding company roads that deteriorated, was located in the unprofitable category.

Generally, the poorer performance roads and the most active diversification were located in the far right grouping (Table 2) of unprofitable railroads. As one moves to the left towards the profitable with non-rail assets, the railroad performances improve and the extent of diversification generally decreases. This is consistent with the predictions made earlier that the less profitable railroads were more likley to diversify and to allow the railroad to deteriorate.

Finally, the existence or lack of non-rail assets was proposed to affect the strategy of diversification. Roads with significant non-rail assets could be expected to spin-off those assets and enter few new industries. The lack of non-rail assets would lead the holding companies into fields totally unrelated to railroads. The three railroads that had significant non-rail assets followed a diversification strategy of spinning off the non-rail assets but entered few new fields. Coincidentally, the three roads were also three of the more profitable roads and all three experienced no change or had an improvement in performance.

CONCLUSIONS

The model proposed in this study defined railroads on the basis of profitability and the expected profit gap between the railroad and alternative investments within the holding company. The larger the profit gap, the more diversification was expected. As the railroad became relatively less important in the holding company, deteriorated performance and eventual disinvestment of the railroad were predicted.

The results indicate that those railroads that were least profitable, and therefore had a large profit gap between rates of return from alternative and railroad investments, diversified heavily until the railroad became a relatively minor part of the holding company operation. The fears of excess disinvestment and deteriorated performance for holding company railroads appeared to be justified only for those railroads that were weak in financial and operating terms going into the holding company.

Four railroads (CNW, MILW, WP, MKT) suffered in terms of performance and all were unprofitable with significant profit gaps and moderate to heavy diversification. Included in that group is the MILW which is in bankruptcy and the CNW and WP, both of whom have been sold by their respective holding companies.[13] One railroad, the ICG, that was in the profitable category, declined in performance after 1970. During the past 1970 period, ICG's profits were just high enough to put it in the profitable category; but Illinois Central Industries commenced an active diversification program. The result was neglect of the railroad and recent attempts to sell the railroad.[14]

Most of the holding company railroads exhibited no change or improvement in performance after the formation of the holding company. This indicates the holding company itself was not necessarily a detrimental development in the railroad industry. One could argue that the most inefficient and poorest railroads could be expected to deteriorate in terms of relative performance whether the holding company was formed or not. This may be true, but the holding company appears not to have been the source of salvation for poor railroads as many holding company proponents have argued in the past.

The investigation results reveal that the holding company device has had little impact on healthy railroads but may have accelerated a deterioration in performance for those roads that were weak prior to the formation of the holding company. Disinvestment appears to have been the ultimate objective for the weaker roads.

When railroads initially formed holding companies, there was widespread concern that the performance of the railroad would deteriorate using the holding company as the vehicle for disinvestment. Similar fears have been expressed for other regulated firms that have formed holding companies in trucking, the airlines, and public utilities. The results of this investigation indicate that a general concern for deteriorated performance in the regulated firms is not warranted. However, the relationship between the regulated firm and the holding company should be monitored with special concern for those regulated firms that were in the most questionable or poorest financial condition before the formation of the holding company.

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Senator **Baucus**. Dr. Sattler, if I may ask, how long have you been studying this question, or how did you get into holding company analysis? What led to this?

Dr. **Sattler**. I have been studying this phenomenon for about 8 years. I originally became interested in it because my specialty in economics, in addition to transportation economics, is a field called industrial organization, which roughly translates into the study of industry structures and how those structures affect economic performance. I noted the rapid movement of railroads into holding companies and wondered if that would have any impact on the railroad itself.

I should state that if there was not a substantial public interest in maintaining rail service, if the railroad were just XYZ Corp., and a holding company was formed, and if the XYZ Corp. was eventually dropped because it did not earn sufficient return, there would really be no problem with that. That is the private market at work. It is the public interest aspect of the railroad that really causes the problem; the fact that the Government is charged with maintaining an effective transportation system. So I was, in my research, motivated to find out if this change in the structure of the company would have any impact on the railroad itself.

Senator **Baucus**. As I understand, your general conclusion is that the larger the profit gap between the railroad and its diversified properties—that is, the lower the return in the profits of the railroad, compared with the other properties, the greater the chances are that further diversification will occur at the expense of the railroad? Is that basically it?

Dr. **Sattler**. That is correct. The more unprofitable the railroad going into the holding company, the more likely that profit gap will be greater. Research has indicated to me that the larger that profit gap, the more rapid the diversification; the more rapid the diversification, the more deterioration occurs in the railroad performance.

Senator **Baucus**. As I understand it, you say the Burlington Northern Railroad operations are in the middle, that is, among those that you have studied?

Dr. **Sattler**. That is correct. Particularly among the western roads, they are certainly not one of the more efficient nor one of the more profitable western roads. But all the western roads are generally more profitable than most U.S. railroads. So viewed with respect to comparable railroads, namely, the roads in their region, the western roads, they are average to below average.

Senator **Baucus**. Would you say you are for or against regulation of the transportation industries? Where are you in all this?

Dr. **Sattler**. Well, I am in somewhat of a difficult position, because I am really for the deregulation of the transportation industries. I was very much for the deregulation of the airline industry; I am for the deregulation of trucking, and I am for the deregulation of the railroads, as well. I believe in giving the railroad companies' management sufficient room to make business decisions that either fail or succeed on their own and not be hindered by regulations. So in that sense, I am very much against regulation.

Senator **Baucus**. But you seem to want more monitoring by the ICC, apparently.

Dr. **Sattler**. That's right, and implicitly, that is a form of regulation. But I think it is important here to go back to the formation of the holding companies, which I would argue, was to escape the regulation. Now, we still have regulation. If the partial deregulation in the railroads results in more efficient railroad performance and higher rates of return, then given my theory and model, we really have very little to fear, because the railroads will be doing very well, competing with alternative investments. The monitoring will then become a redundant activity. But at this point, with the relatively low rates of return of the railroad, I think that we ought to monitor this holding company activity because it has been a clever attempt by railroad firms to escape Interstate Commerce Commission regulation. And I might add, I am not at all unsympathetic to their attempt. I think any business, by its very nature, wants to escape regulation that results in low profits. The monitoring is justified on the public interest argument mentioned earlier.

Senator **Baucus**. Do you have any examples, or do you know of any instances, where there was a railroad that was relatively healthy before a holding company was formed, but then deteriorated?

Dr. **Sattler**. Yes. I can cite one example, the Illinois Central Gulf Railroad. In 1962, the Illinois Central Gulf Railroad formed a holding company, Illinois Central Industries. The chief executive of the holding company, Mr. Johnson, steadfastly maintained that his interest was to maintain the railroad at all costs, and in fact, the holding company would work to the advantage of the railroad, raise more capital, would plow that capital back into the railroad, and he argued that the holding company was the most wonderful thing ever to happen to the railroad industry.

By 1967 or 1968, Illinois Central Industries had started to diversify rather heavily, and they started to acquire a number of other business firms. By the early seventies, their diversification had increased to such an extent that the railroad had less than half of the total operating revenues of the holding company, and all of a sudden, the maintenance policy with respect to the railroad changed. Less money went into the railroad. The financial health of the railroad deteriorated, and Illinois Central Industries now finds itself in the position of owning Dad's Root beer, Pepsi-Cola Bottlers, Midas Muffler—a number of firms having little to do with the railroad, but trying to sell the railroad right now. In fact, they have been trying to sell the Illinois Central Gulf for several years.

Senator **Baucus**. But is it fair to say that this is an exception, though, to your final analysis?

Dr. **Sattler**. It is an exception to my general analysis.

Senator **Baucus**. And if that is true that it is an exception, what happened here? What explains the exception?

Dr. **Sattler**. Well, apparently, as the company diversified other investments were more attractive. You have to remember that even though the Illinois Central Gulf Railroad was relatively profitable as railroads go, it was still well below the overall average rate of return for overall industry. Therefore, alternative investments became more and more attractive to the holding company, and as a result, they needed money. They used the money from the railroad to buy all of these other firms and the railroad suffered.

Senator BAUCUS. And how does that situation compare with the BN?

Dr. SATTLER. Well, the Burlington Northern Railroad at this time has been improving its profitability. It is attempting to increase its operating efficiency. If they are able to do all of that, and if the economy rebounds so that they and all other railroads will have higher rates of return, then the railroad can more effectively compete with the natural resource divisions of the holding company and will probably not be hurt that much.

Senator BAUCUS. So in your view, one of the determining factors is the general health of the economy?

Dr. SATTLER. Well, that seems to have more of an impact on the railroads than it does the natural resource divisions. The railroad is an industry that is particularly impacted by swings in the economy. So that, yes, I would say that that has a significant impact on this.

Senator BAUCUS. Other than just general attention to management, what other factors can you think of that tend to point to whether a railroad, as in BN's situation, where it is in the middle of the scale of healthy to unhealthy, will growth healthier or less healthy, other than attention to management and other than the general economy?

Dr. SATTLER. Well, at this point, predicting what is going to happen in the next 5 to 10 years, and what is going to happen to the size of that profit gap is very difficult, because a number of variables are going to impact on that. But I would note Mr. Bressler's own statement, that financial resource divisions are going to expand significantly over the next few years. So if a railroad is going to continue to be successful in competing for funds, it had better stay profitable over the next 5 to 10 years. If it does not, then it is in trouble. At this point, I—and I do not think any economist can—cannot predict what is going to happen to the railroad industry over the next 5 to 10 years.

Senator BAUCUS. So if I understand you, you would anticipate that there would not be a rapid diversification into nonrail activities in the short run or in the middle term, that is, in the next 5 or 6 years; is that right?

Dr. SATTLER. Well, in the short run, I would not anticipate that the railroad would be harmed. Now, it is possible to diversify in the short run without hurting the railroad substantially. Typically, where the railroad gets hurt is over a span of 5 or 10 years, let us say, a track is undermaintained, and all of a sudden, the railroad finds, 10 years down the line, that the track is no longer operable. It is then no longer safe to operate at normal speeds and that destroys the operating characteristics of the railroad and hurts the railroad financially. So the potential for harm in this is really over the longer term.

Senator BAUCUS. Would you expect less capital to flow from the land grant assets to the railroads?

Dr. SATTLER. I would, because as Mr. Bressler points out in the annual report, all the divisions are operating on a basis of a profit center arrangement, which is to say that each division is responsible for generating its own profits. If it turns out that the natural resource divisions are in fact more profitable than the railroads, then they will get preferential treatment in terms of capital funds. So, yes, I would definitely believe that.

Senator BAUCUS. What kind of increased monitoring do you have in mind?

Dr. SATTLER. I was encouraged to note that the Interstate Commerce Commission appeared to be open to increasing the frequency of the monitoring and, hopefully, some of the detail of the monitoring of holding company transactions. I would particularly be interested in the Interstate Commerce Commission maintaining a very close watch on such things as the maintenance policy of the railroad. This is one of the avenues of potential disinvestment that was noted by the Interstate Commerce Commission as far back as 1970. So I would want them to look at the maintenance policy of the railroad; I would want them to analyze the operating characteristics of the railroads, such as the operating ratio; I would think that they should look at the dividends paid by the railroad to the holding company, and as well as fees paid by the railroad to the holding company, other avenues of potential disinvestment. In other words, we know from the theory and from practice that there are certain ways that assets are transferred from the railroad to the holding company, and we ought to use that knowledge to monitor these holding company/railroad relationships.

Senator BAUCUS. I appreciate that very, much. In fact, it would be helpful to this committee if you could, for the record, list the kinds of areas—and you have already done so in part—the kinds of inquiries and areas that you feel the committee or some appropriate agency should look at in monitoring holding companies.

Your reference to maintenance, I think, is critical. In my experience with the Milwaukee Railroad maintenance, the Milwaukee deteriorated long before the company made known its intentions to reduce its operations and also long before it became clear that the road was going into very difficult financial condition. That maintenance policy, I think, is very critical; I agree with you.

Dr. SATTLER. By the way, you mentioned the Milwaukee Road, and I would like to point out one thing. We should not be too fearful of the holding company in the sense that Mr. Martin went to quite detailed lengths to indicate that the Milwaukee Road was in trouble long before the holding company. I would agree fully that the Milwaukee Road was in financial trouble long before the holding company and the holding company only provided a vehicle to get rid of the railroad, to divest the railroad. A holding company is not necessarily the enemy here, if you want to think of it that way, but the problem is the low rates of return of the railroad. The holding company is not directly responsible for that, but it does provide a vehicle for the divesting of the railroad.

Senator BAUCUS. Thank you very much. We appreciate your testimony.

Dr. SATTLER. Thank you.

Senator BAUCUS. For the remainder of the afternoon, I am afraid we are going to have to restrict the presentations of each witness to 6 minutes. I am going to have a light system up here, and I think it will work this way, that for 5 minutes the green light will be on; when the green light goes out and the amber light goes on, that is 1 minute remaining; and when the red light goes on, well, we will cross that bridge when we come to it. But I am going to be firm on this policy for one simple reason. Some committees tend not to be punctual. Airlines are punctual, and I am going home to Montana, and I have a flight to catch. So we will have to adhere to the 6-minute rule—although I probably will have some questions in addition.

Next, we will hear from Richard Kilroy, and Mr. Pat Foley.

Mr. Kilroy, why don't you begin?

STATEMENT OF A PANEL INCLUDING RICHARD I. KILROY, EXECUTIVE SECRETARY-TREASURER, RAILWAY LABOR EXECUTIVES' ASSOCIATION, INTERNATIONAL PRESIDENT, BROTHERHOOD OF RAILWAY AND AIRLINE CLERKS, AND A VICE PRESIDENT, AFL-CIO, ACCOMPANIED BY WILLIAM G. MAHONEY, COUNSEL TO RLEA; AND PATRICK J. FOLEY, ATTORNEY, DE PARQ, ANDERSON, PERL, HUNGES & RUDQUIST, MINNEAPOLIS, MINN.

Mr. KILROY. Thank you, Mr. Chairman. I appreciate the opportunity to appear here before the committee. We have submitted a statement, so I will not, of course, go into all of the detail of that statement, but try to just highlight it.

My name is Dick Kilroy. I am international president of the Brotherhood of Railway and Airline Clerks; a vice president of the AFL-CIO, and I am also executive secretary of the Railway Labor Executives' Association, which represents all of the rail unions as shown in the statement. I am also accompanied by Mr. William G. Mahoney, counsel to the RLEA, and I would ask that you please enter my complete statement in the record, and I will attempt to highlight it.

Senator BAUCUS. Yes, your whole statement will be included.

Mr. KILROY. Thank you.

The employees of the BN, whom our unions represent, are greatly concerned about the recent public pronouncements emanating from Burlington Northern Industries, some of which appeared in the March 8, 1982, edition of Business Week magazine, which indicate that company intends to use the corporate form of a holding company to milk the transportation profits from the Burlington Northern Railroad Co. in order to fund speculative resource development and oil company acquisition. If this course of conduct is permitted, it ultimately will prove detrimental to the physical plant of the BN railroad and its employment base, thereby directly affecting its employees. And it is the employees and the hundreds of small shippers who will suffer most in BNI's proposed venture as yet another publicly insensitive corporate giant propelled by but one consideration—the highest profit attainable, regardless of cost to the public.

It would seem the consideration owed employees and shippers in the case of the BN is intensified by the fact that through the action of the Interstate Commerce Commission, three transcontinental railroads—Great Northern, NP, and Milwaukee—were reduced to two, BN and Milwaukee, and then reduced to one, BN, with BN receiving operating rights and perhaps ultimately title to all the better lines Milwaukee was forced to relinquish. The BN Railroad was and is substantially supported by land grant assets which provided great sums of cash to fund railroad development in the West in the last century. The Northern Pacific Railroad, which in 1970 became part of the BN by merger in 1970 with the Great Northern and the CB&Q Railroads, was this Nation's largest land grant railroad.

I want to, then, really digress just a little bit if I may, Mr. Chairman, and point out, as I heard also mentioned here this morning, and of course, one of our direct interests is the public service aspect of the railroad industry, which we have always felt has been paramount, and not the least of our concern, of course, is the impact, and the adverse impact, on the employees. When you questioned this morning about what the benefits of mergers were to the officials of the company or others that you have talked to here this morning, we know invariably it is not to our best interest, because invariably, we lose. As was pointed out, the BN has less employees now than when the BN and Frisco jointly were separate. So we feel the impact of that, and those employees, of course, are citizens of some of Montana, too, as you probably know. So those social problems that impact on employees are vital—vital to the national economy and national defense.

I just want to point out and recall briefly what happened in the Penn Central situation. All of these situations are distinct. But if you may recall, the Penn Central merged February 1, 1968. On October 1, 1969, a holding company was formed. Now, there were three structures to the Penn Central. They had the Penn Central Co., which was a holding company; the Penn Central Transportation Co., which was the railroad; then, a third tier, the Pennsylvania Co. called PenCo. Now, PenCo owned all of the nonrail assets. Eight hundred and seventy-two days later, as history will show, only the railroad went backrupt. So we think that sometimes, there is a direct connection between forming holding companies, and in the event that something happens to the railroad, that they could no longer make a profit out of it, it is much easier to get rid of the railroad part. I recall the Chicago & Northwestern sold their railroad part, that is the industry as a holding company sold that to the employees.

Both the Interstate Commerce Commission and congressional leaders in the Penn Central case maintained that PenCo, which owned the nonrail assets, were responsible for drawing away cash from the railroad. So now, we have Penn Central and six others, turned over to the U.S. Government, which as formed is now ConRail, and as you know, at considerable cost to the Federal Government and the taxpayers, running into the billions of dollars. I think the very essence of the essential nature of the railroad industry means that the Federal Government should have a very keen interest in what is happening, because they may wind up paying the bill in order to maintain those railroads in the future.

I see that the light has come on and my time is about up. Thank you very much. I will be glad to answer any questions that you might have with respect to my statement.

Senator BAUCUS. Thank you very much, Mr. Kilroy. You are obviously one of the experts in this area, particularly on Penn Central, and I appreciate your reference to that.

Mr. Foley, why don't you proceed? I notice you have a 125-page or so statement here. If you can get that in in 6 minutes, you are a better man than I.

Mr. FOLEY. I assure you, Mr. Chairman, that I will not read that verbatim.

Senator BAUCUS. I wish we had the time.

Mr. FOLEY. Mr. Chairman, I deeply appreciate the opportunity you have given to me to register my protest to the railroad holding company developments.

I speak for a group of unions representing employees, approximately 45,000 in number, employed by the Burlington Northern Railroad. While I appreciate my statement is quite lengthy, we have a very serious problem about which we in labor feel very deeply. It is a little bit like the original question posed to George Stephenson, the original designer of the locomotive. He was asked what would happen if the cow ran into the locomotive. The laconic Scottsman said, "It would be very bad on the cow." And so, we look at the transactions of the Burlington Northern and the holding company as very bad on railway labor.

For instance, Mr. Martin this morning told the committee and the chairman that vision, courage and fierce dedication seldom occur in combination in one person. You are aware that they have announced the sale of the BNAFI, which cost the railroad $3 million, nets an income of $25 million now, and they sold it for $177 million. One legitimate business periodical called it "corporate stupidity at its worst."

Mr. Bressler this morning suggested that there is no deterioration in the Burlington Northern's commitment to railroads. Last year, they reduced the miles of new and second hand trackage installed from 1,675 miles to 1,449 miles. They reduced the number of new, installed ties from 4.2 million ties to 2.9 million ties. They reduced the installed new cubic yards of crushed rock from 3.8 million yards to 3.3 million yards.

Mr. Bressler said this morning that to implement management, the railroad has transferred accounts receivable and payable relating to these businesses to the four resource companies, and starting in January of this year, the railroad has been declaring monthly dividends in amounts equal to the net proceeds from its natural resource properties.

What does that mean? We hear about profit centers for the Burlington Northern, Mr. Chairman. They are talking about how difficult it is for Plum Creek to compete with somebody else. I would like to compete on those terms. Do you know what they did? They got all of their assets free. Somebody else who wanted to compete with Plum Creek would have to go out and buy the assets before they processed it and sold it to the public. All of these assets are being transferred either by title, cost-free from the railroad, or they are being transferred in terms of their income from the railroad to the separate profit centers. Those are not profit centers. They are all a gift. That is all it is. All it is is a clear rip-off of the railroad assets that have been devoted and dedicated for over 100 years to the maintenance of the railroad industry.

Now, if there be any doubt about it, you can read the statements of the presidents of the Great Northern and the Northern Pacific at the time that they induced the formation of the original Burlington Northern lines—the CB&O, the Great Northern, and the Northern Pacific.

Mr. McFarland of the NP was faced with a very serious problem because there is a group of people in the Northern Pacific who at that time wanted to separate the natural resources from the railroads. The railroads opposed that. The Commission, allowing the merger, stated that consideration was given to issuance of two classes of stock and spin-off of the natural resources, but it was concluded that all Northern properties would have to be included in the agreement.

In the Frisco merger, there was no doubt about these problems. The Commission by that time had told Congress that they had the authority to exercise jurisdiction over a holding company owning two or more carriers. The legal fiction in this system of a single, integrated railroad is pure nonsense, because if that were true, the statute would have provided one system irrespective of the separate corporate numbers. The statute provides two more carriers. They own about 20 or 25 separately certificated railroad carriers, and they control others. In the Frisco merger, there was no question but the non-transportation operations permitted the BN to commit internally-generated funds for the railroad.

The Burlington Northern is like the Milwaukee. The Milwaukee is in tough shape, and they sold out 93,000 acres of timberland for $134 million, a second sale of $45 million, and a third sale of $100 million last year. They are all getting rich in the holding companies, and the railroads are going cash broke. We have had defective governmental regulations that have resulted in very severe problems. We have had the DC–10, we have had Penn Central, Milwaukee Road, we have had the Rock Island, and we have had other things that have unnecessarily occurred, and we just hope, on behalf of the 45,000 employees represented by my union, that it does not happen to the Burlington Northern.

I do appreciate your courage in having a meeting here, in public, where the public can come and voice its concern about the vary serious problems.

Thank you very kindly, Mr. Chairman.

Senator BAUCUS. Thank you, Mr. Foley.

Do you, Mr. Kilroy, or you, Pat, have any points you want to make in rebuttal to any points that were made this morning, or a couple of additional points you want to make that were not made this morning in this testimony?

Mr. KILROY. Yes, just, I think, one or two, Mr. Chairman. The question came up frequently about what should the ICC do, or what would be recommended that they do with respect to monitoring and reviewing holding companies, and I think that we would suggest there, not only monitoring and review, but some authority to do something about it. It is easy enough to go in and say, yes, there is something wrong, but we have no authority to do anything about it, such as said with respect to formation of holding companies in the first place. They said, yes, maybe we would have a right to take a look at it, but we would have no right to stop it. So that when the committee considers legislation, perhaps they would consider that the legislation must be more than just monitoring and review.

In this morning's testimony was mentioned one of the old—I think we used to call them "robber barons"—but regardless of what that history is, you know, Vanderbilt said, "The public be damned." Well, let us not let the public be damned again, when we review the situation of our Nation's railroads.

Thank you.

Senator BAUCUS. Pat, are there any other points you want to add?

Mr. FOLEY. One other, Mr. Chairman, very briefly. In the Chessie Merger Order of 1980, the Commission pointed out, in reviewing the problems of the noncarrier holding companies, that the Commission should be aware of whether there would be a substantial influence on national transportation.

Now, here, we have a railroad that has as its two primary cargoes, coal, and grain. If there be a drought out in the West, and the grain shipments go down, and if the price of oil goes down, the Western railroads are going to lose their two prime cargoes. Now, I do not attribute any particular importance at this stage, but we do not know yet, to the fact that, as I pointed out in my detailed statement, the Nation of Kuwait owns about $10 million of stock in the Burlington Northern. I do not think Kuwait is dedicated to the preservation of the railroad system in this country.

It just seems to me that there is such an overpowering importance to one railroad, primarily devoted to two cargoes, operating in 27 States, that if those two go down, there is nothing that is going to save that railroad except the Burlington Northern holding company, and it will not.

Senator BAUCUS. I want to thank you both very much, and particularly you for your detailed statement, Pat; I will make sure that is in the record, as well as yours, Mr. Kilroy.

Thank you very much.

[Prepared statements follow:]

STATEMENT OF RICHARD I. KILROY, EXECUTIVE SECRETARY-TREASURER, RAILWAY LABOR EXECUTIVES' ASSOCIATION

My name is Richard I. Kilroy. I am Executive Secretary-Treasurer of the Railway Labor Executives' Association, the International President of the Brotherhood of Railway and Airline Clerks and a Vice President of the AFL-CIO. I present this statement on behalf of the Railway Labor Executives' Association. The RLEA is an unincorporated association with offices in Washington, DC.

The membership of the Association consists of the chief executive officers of twenty standard national and international railway labor organizations. They are:

American Railway & Airway Supervisors Association, Division of BRAC
American Train Dispatchers Association
Brotherhood of Locomotive Engineers
Brotherhood of Maintenance of Way Employes
Brotherhood of Railroad Signalmen
Brotherhood Railway Carmen of the United States and Canada
Brotherhood of Railway and Airline Clerks
Hotel & Restaurant Employees and Bartenders International Union
International Association of Machinists and Aerospace Workers
International Brotherhood of Boilermakers and Blacksmiths
International Brotherhood of Electrical Workers
International Brotherhood of Firemen & Oilers
International Longshoremen's Association
International Organization of Masters, Mates and Pilots
National Marine Engineers' Beneficial Association
Railroad Yardmasters of America
Sheet Metal Workers' International Association
Seafarers International Union of North America
Transport Workers Union of America
United Transportation Union

The railroad industry in recent years has begun to effect mergers through the device of the holding company. For example, there was the creation of the Penn Central Transportation Company of painful memory; thereafter CSX was created which controlled both the Chessie System, itself a holding company, and the Family Lines; then came the Norfolk Southern, a holding company controlling the Norfolk and Western and the Southern Railway Lines; and, of course, BNI.

So long as the holding company has the interests of its railroads and those they serve uppermost on its list of priorities there may be little about it that is contrary to the public interest. When that is not the case, the public interest may be seriously and irreparably damaged. Recently, the United States Court of Appeals for the District of Columbia Circuit expressed well the dilemma of the management of a holding company when it said:

> "It is a fact of life that those charged with managing two corporations have dual responsibilities that may not always mesh to serve the best interests of both companies." (Emphasis by the Court.)

I appear before you today to express the support of the membership of RLEA for legislation which would require intensive review and appraisal by the Interstate Commerce Commission of the formation of holding companies such as BNI and continuing review authority over such companies to guarantee that railroad profits are not diverted to speculative non-rail ventures of the corporate relatives of railroads. Such cash raids on railroads would have a detrimental impact not only on rail employees, but also on our vital national system of rail transportation.

The employees of BN whom our unions represent are greatly concerned about the recent public pronouncements emanating from Burlington Northern Industries, some of which appeared in the March 8, 1982, edition of Business Week magazine, which indicate that company intends to use the corporate form of a holding company to milk the transportation profits from the Burlington Northern R.R. Co. in order to fund speculative resource development and oil company acquisition. If this course of conduct is permitted, it ultimately will prove detrimental to the physical plant of the BN railroad and its employment base, thereby directly affecting its employees. And it is the employees and the hundreds of small shippers who will suffer most in BNI's proposed venture as yet another publicly insensitive corporate giant propelled by but one consideration--the highest profit attainable regardless of cost to the public. Such an objective may be laudable to some under our system of capitalism but it represents a public menace when the company to which it is applied is charged with so vital a public interest as rail transportation.

The top officials of BNI who propose to accomplish its grand design are not railroad people. They came from the petroleum industry--and if the Business Week's article is correct their primary business interest remains oil for their immediate objective is to improve BN's operating ratio by 3.5 percentage points to 87.5% and use the cash generated to acquire an oil company. It cannot be expected of corporate executives who have never operated a corporation charged with a vital public interest such as a railroad to be sensitive to that interest. It is natural for them to view the bottom line on the combined financial account as all important.

Times may change, technology may change, economics may change, but human nature remains constant. A return to the unrestrained times of the robber barons of the last half of the 19th Century will bring about the same results suffered by those without economic strength in those days. And--like then--following a period of economic brutalization of the "have-nots" by the "haves," government will be compelled to act.

It has been rather accurately observed that "people and governments never have learned anything from history, or acted on principles deduced from it" and "those who cannot remember the past are condemned to repeat it." We respectfully ask that this Committee and the Congress remember the lessons of history and place a vigilant watch on those who so vitally affect the public interest. It would seem the consideration owed employees and shippers in the case of the BN is intensified by the fact that through the action of the Interstate Commerce Commission, three transcontinental railroads (GN, NP, and Milwaukee) were reduced to two (BN and Milwaukee) and then reduced to one (BN) with BN receiving operating rights and, perhaps ultimately title, to all the better lines Milwaukee was forced to relinquish.

The BN railroad was, and is, substantially supported by land grant assets which provided great sums of cash to fund railroad development in the West in the last century. The Northern Pacific Railroad, which in 1970 became part of the BN by merger in 1970 with the Great Northern and the Chicago, Burlington & Quincy Railroads, was this nation's largest land-grant railroad. BNI's officials, however, have lowered capital expenditures to maintain this privately owned, yet public asset. Capital expenditures were reduced from a high of $600 million annually in 1980 at the time of merger of the BN with the St. Louis-San Francisco Ry. (Frisco) to less than $400 million in 1981. Employment levels have been cut back to such a point that employment on the combined BN/Frisco is less now (47,002) than it was on the BN alone prior to the merger of the two railroads (47,154).

There can be no doubt that the Interstate Commerce Commission should spend more time and greater energy focusing upon holding company financial activities which may be detrimental to the national rail transportation system and railroad employment. Although the Interstate Commerce Commission does have authority to review and approve the extent to which commitments are made of rail assets to non-rail ventures [49 U.S.C. §11301 (authority to certain carriers to issue securities and assume obligations and liabilities)], it has failed to effectively perform that duty. The results of the activities of the Penn Central Transportation Company are still being felt by the taxpayer.

BNI has evidenced a disdainful attitude toward its shippers on the line of the BN. Last June, BN noted its intention to abandon 2,500 miles of branch lines in Montana, North Dakota, and Nebraska, which provoked vehement protests from farmers, grain elevator operators, and shippers in all three states. This attitude carries over to BNI's relationships with its rail employees on the BN. Gordon K. Williams, General Chairman of my Brotherhood, the Brotherhood of Railway and Airline Clerks on the BN, was quoted recently in the March 8, 1982, edition of Business Week, as saying, "there is discontent in the ranks and morale is low, . . . we wouldn't have any trouble taking the people out [on strike]." Efficiency of operation is bound to suffer in such a situation as that.

Neither BNI nor any other railroad holding company should be provided the opportunity or incentive to raid the profits of their railroad subsidiaries. Current legislation appears inadequate to deal with this problem. Furthermore, the statutory authority of the Interstate Commerce Commission to approve any assumption of obligation, or pledge of assets by a rail carrier has not been used to maximum affect to insure that rail assets are not placed in jeopardy on account of the debts of a corporate relative. I would again mention here our Penn Central experience.

The solution to this problem must be new legislation giving the ICC expanded authority to control the shifting of profits from rail assets to non-rail enterprises with sufficient guidelines to insure the ICC's carrying out the intent of Congress. It must be made clear to the ICC that this new authority must be exercised in conjunction with its current merger powers and its authority to approve assumption of obligations and pledge of assets by carriers on account of the debts of a non-rail corporate relative. Only vigilant oversight by the ICC can assure retention by rail carriers of that portion of their profits sufficient to insure the continued viability of our national transportation system and its service to the nation's shippers.

For the reasons stated above, we respectfully submit that reason and logic, as well as the economic and energy demands of this nation dictate the delegation of greater power to, and more active enforcement of the law by, the ICC to curb corporate conglomerate activities which militate against maintenance of a viable national rail transportation system.

Thank you for permitting us the opportunity to present to you the position of the Railway Labor Executives' Association on this vitally significant national problem.

STATEMENT BEFORE

THE UNITED STATES SENATE COMMITTEE ON THE JUDICIARY
RAILROAD MERGERS

MARCH 26, 1982, WASHINGTON, D.C.

PATRICK J. FOLEY
DeParcq, Anderson, Perl, Hunegs
& Rudquist, P.A.
565 Pillsbury Building
Minneapolis, Minnesota 55402
(612) 339-4511

FOR AND ON BEHALF OF CERTAIN GENERAL COMMITTEES AND SYSTEM BOARDS OF STANDARD RAILROAD ORGANIZATIONS ON BURLINGTON NORTHERN PROPERTY

STATEMENT

Patrick J. Foley
DeParcq, Anderson, Perl, Hunegs & Rudquist, P.A.
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TO: The United States Senate
Committee on the Judiciary
Railroad Mergers

March 26, 1982, Washington, D.C.

Mr. Chairman and members of this Committee:

The Railroad Brotherhoods which I represent for this appearance wish to extend through me their deep appreciation for your time and courtesy in extending this opportunity to address you on behalf of them on the subject of railroad mergers. My appearance is made in connection with the following union officers and system boards and general committees as follows:

Gordon Williams, General Chairman
James G. Dooley
Senior Vice-General Chairman
Brotherhood of Railway and Airline
Clerks Consolidated System Board of
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The railway brotherhoods on the Burlington Northern feel a deep identity with the history of that railroad and of railroads generally. A historical review, which I will make brief, demonstrates that there are reciprocating rights and liabilities between railway labor and the railway management, that the two sides when cooperating have built an enormous and efficient transportation system, and that when they disagree the results may indeed be tragic.

Labor has been seen through some eyes like M'sieu le Tramtrack, a character in Brendan Beehan's drama The Scarperer. That Irish writer created Tramtrack, a resident of Paris during the First World War. He was injured when in a traumatic incident with a tram on the Boulevard Saint-Michel. His attorney advised him not to leave his bed until they were paid 70,000 francs. The case was delayed because of the outbreak of the war, adjourned during the battle of Marne, then settled after the termination of the war. By then, the trams were off the streets, and a new action had to be started against the directors for the company was in liquidation. Tramtrack stayed in bed and got little or nothing, according to Beehan.

The Burlington Northern employees played a much more constructive role in the development of the West. The late Hubert H. Humphrey stated many times that the Western railroads enabled the farmers to become the bread basket of the world. There is absolutely no question but that Western United States and railroads have an inseparable history and are even today so deeply involved that they are truly interdependent.

The development of the railroads was not an entirely private development from investors. The history shows for instance that the Penn Central was the product of 600 mergers. The Burlington Northern on the other hand resulted from approximately 102 mergers. The land grants got a late start, for the panic of 1857 resulted in state constitutional prohibitions against railroad aid, and those prohibitions were not removed until after the Civil War.[1] The original land grants, 1857, by the Federal Government, provided that the lines had to be completed within ten years or have the land revert to the Federal Government. The Minnesota carriers could not raise any money, and one Company, the Transit Company, offered 500,000 acres at $1.00 an acre, and could not sell. Construction stopped by July, 1859, and the Governor ordered foreclosure.[2] By June 28, 1862, the historic locomotive William Crooks made its first run from St. Paul to St. Anthony, later of course named Minneapolis.[3]

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[1] The Story of the Western Railroads, Chapter IV, p. 63

President Lincoln created the philosophy of trust between labor and management with these words[4]:

> All that harms labor is treason to America. No line can be drawn between these two. If any man tells you he loves America, yet he hates labor, he is a liar. If a man tells you he trusts America, yet fears labor, he is a fool.
>
> I am glad to see that a system of labor prevails under which laborers can strike when they want to * * * I like the system which lets a man quit when he wants to and wish it might prevail everywhere.

The administration at the time with cooperation from Congress created the means and facilities by which the West would be settled and developed.

Congress on July 2, 1864 enacted the land grant statute for the development of the Northern Pacific Railroad. 13 Stat. 365. The statute provided specific named person "created and erected into a body corporate in politic, in deed and in law, by the name, style, and title of the 'Northern Pacific Railroad Company'". The corporation was authorized to lay out the "continuous railroad." The original one million shares of capital stock were authorized. The named persons were appointed commissioners who shall select a number of officers. Upon the sale of 20,000 shares of stock, the officers would select a meeting place for the stock subscribers and elect 13 director It was held that "* * * and thereafter the stockholders shall constitute said body politic and corporate." The remainder of Section 1 provides as follows:

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[2] Catholic Colonization on the Frontier, Chapter 5, p. 86, James Shannon

[3] 101 Best Stories of Minnesota, p. 209

[4] Labor's Untold Story, Chapter 1, p. 11

> Annual meetings of the stockholders of the said corporation for the choice of officers (when they are to be chosen) and for the transaction of business shall be holden at such time and place and upon such notice as may be prescribed in the by-laws.

The public right-of-way was granted to the Northern Pacific Railroad Company for the construction of a railroad and a telegraph line. Section 3 granted to the railroad "to secure the safe and speedy transportation of the mails, troops, munitions of war, and public stores, over the route of said line of railway, every alternate section of public land, not mineral, designated by odd numbers, to the amount of 20 alternate sections per mile, on each side of said railroad line, as said company may adopt, through the territories of the United States, and 10 alternate sections of land per mile on each side of said railroad whenever it passes through any state * * *."

Section 4 provided for the time of transfer of title to the lands, that is upon the completin of 25 consecutive miles of track. Section 5 required that the work shall be done in a "substantial and workman-like manner * * * equal in all respects to railroads of the first class." That required a uniform gauge.

Section 8 required the completion of the work by July 4, 1876. Sectin 9 empowered the United States to correct breaches of the conditions. Section 10 entitled the people of the United States to subscribe to the stock until the entire capital is taken up. Section 14 provided in part that:

> No person shall be a director of said company unless he shall be a stockholder, and qualified to vote for directors at the election at which he shall be chosen.

Section 19 provides:

> And be it further enacted, That unless said Northern Pacific Railroad Company shall obtain bona fide subscriptions to the stock of said company to the amount of two millions of dollars, with ten per centum paid within two years after the passage and approval of this act, it shall be nulland void.

Section 20 provides:

> And be it further enacted, That the better to accomplish the object of this act, namely, to promote the public interest and welfare by the construction of said railroad and telegraph line, and keeping the same in working order, and to secure to the government at all times (but particularly in time of war) the use and benefits of the same for postal, military, and other purposes, congress may, at any time, having due regard for the rights of said Northern Pacific Railroad Company, add to, alter, amend, or repeal this act.

The originating land grant statute, above quoted in part and paraphrased in part, does not anticipate or allow any dissociation of the land grant assets, the corporation, and its shareholders. The intervention of a holding company violates this statute in two respects: first, it divorces the stockholders of the railroad corporation from that corporation through the intervention of the holding company; second, the basic stratagem for a holding company is to enable assets acquired through the operation of the land grants, through the operation of the railroad, to be transferred to corporations dissociated from the operation of the railroad and therefore not to be used in maintaining or keeping the same in working order.

The Supreme Court has interpreted the land grant statute and has held that the grants of land involve contractual responsibilities. In United States v. Northern Pacific Ry. Co., 256 U.S. 51, 41 S.Ct. 439 (1921), the Government was to cancel a particular patent of land in Montana. Those lands were indemnity lands granted to the N.P. under the original land grant statute. The party there was the Northern Pacific Railway Company, a successor to the Northern Pacific Railroad Company. The Court pointed out:

> The rights and obligations of the original railroad company arising out of the grant have long since passed to the present railway company and there is no need here to distinguishing one company from the other. 41 S.Ct. at 439.

The Court reiterated the purpose for the grants to be the aiding in the construction of the railroad. The indemnity lands were granted to the company from unoccupied, non-mineral lands as a substitute for other property. The company was to accept in writing the terms on which the grant had been made. The company accepted those terms and filed the appropriate maps. The railroad location was completed in 1884, and the construction was completed in 1887. The losses in the grant because of other disposals and homestead settlements and others were to besupplemented by the indemnity limits as provided for in the granting act. The N.P. then did select its lands; however, the Government had issued a temporary executive withdrawal of some of the land a year before the selection by the N.P. That withdrawal was originally overlooked on the issuance of the patent, and the Government then sued to cancel the patent. The N.P. contended that the temporary withdrawal by the United States did not affect the N.P.'s right to select the lands and that the Government was not prejudiced. The company argued further that the withdrawals and exemptions reduced the amount of available land. The Government contended that no rights attached to any land specifically until selected; that the Government can withdraw or reserve any land up to the time of selection; and the right to exempt land exists even when the limits exceed the available land in the indemnity limits. The Supreme Court in a very extensive memorandum opinion made the following comment:

> The purpose of the granting act and resolution was to bring about the construction and operation of a line of railroad extending from Lake Superior to Puget Sound and Portland through what then consisted of great stretches of homeless prairies, trackless forests and unexplored mountains, and thus to facilitate the development of that region, promote commerce, and

> establish a convenient highway for the transportation of mails, troops, munitions and public stores to and from the Pacific Coast, with all the resultant advantages to the government and the public. To that end the act and resolution embodied a proposal to the company to the effect that if it would undertake and perform that vast work it should receive in return the lands comprehended in the grant. The company accepted the proposal and at enormous cost constructed the road and put the same in operation; and the road was accepted by the President. * * *

The Court there stated in so many words that "thus the proposal was converted into a contract, as to which the company by performing its part became entitled to performance by the Government:" 41 S.Ct. at 441. The Court had held that the rights and obligations of the original railroad company pass to the present railway company. Thus, it would appear that the contract involve both rights and obligations between the two parties, the United States and the railway.

There being a contract here, it would appear from the plain terms of the contract, that is the land grant statute, that there are rights and obligations and that the carrier, presently the Burlingto Northern Inc., may not separate the land grant assets from the railroad and may not divorce the land grant assets from the shareholders.

The contract manifested by the statute clearly anticipates an on-going railroad. Section 3 provided that the railroad and its successors were granted the public lands for the purpose of aiding in the construction of the railroad. It provides further that that railroad would secure the safe and speedy transportation of the mails, troops, munitions of war, and public stores. Section 5 required that the railroad would be constructed in a workmanlike manner "equal in all respects to railroads of the first class." Section 11 required the railroad to be a post road and military road subject to the United States. Other sections contribute to those rather specific mandates to construct and maintain an on-going railroad. Section 8 required that the grants would be made on conditions relating to the starting and completion of construction work. Section 9 provided that the grants were conditional but that there are remedies against the railroad if it accepts them and then breaches the conditions.

It would transcend all sense of legitimate statutory or contractual interpretation for any Court to conclude that the land grant statutes were complied with by the construction of the railroad without a concomitant obligation on the part of the railroad company to operate the railroad.

Congress on May 31, 1870 passed a joint resolution to authorize the company to issue bonds to be secured by a mortgage. It further provided for the location and construction of the main railroad via the Columbia River to Puget Sound in Washington. See United States v. Northern Pacific Ry. Co., 311 U.S. 317, 61 S.Ct. 264, 269 (1940). The 1870 resolution modified the route that had been authorized by the original Act of 1864. The resolution, however, in referring to the 1864 Act authorized the location and construction "Under the provisions and with the privileges, grants, and duties provided for in its act of incorporation." 61 S.Ct. at 289. It is therefore obvious in so many words that there are rights and obligations imposed by the incorporating act of 1864.

The Supreme Court has uniformly observed the contractual nature of the land grant statute of 1864. It was described in St. Paul & P.R. Co. v. Northern Pac. R. Co., 11 S.Ct. 389, 390 (1891) as follows:

By the expressed declaration of the act the

> grants were made and the rights and privileges were conferred upon and accepted by the company on the condition that it should commence work on the road within two years from the approval of the act by the president, and to complete and equip the whole road by the 4th of July, 1876; and the further condition that, if the company should make any breach of the conditions of the grants, and allow the same to continue for upwards of one year, then at anytime thereafter the United States might 'do any and all acts and things' needful and necessary to insure a speedy completion of the road.

The Court went on to say the following:

> Although the restraints in the act against the sale or alienation of the lands when once identified are not the subject of consideration in the present case, it may be well, to obviate misapprehension, to observe that the company, notwithstanding its possession of the title, was not at liberty to dispose of the lands without the consent of Congress, except as each 25-mile section was completed and accepted by the president, so as to deprive the United States of the right to compel their application to the purposes of the grant, or so as to prevent their forfeiture in case of the company's failure to comply with its conditions. Congress, in allowing a mortgage upon the land, and in other ways, may have granted permission to the company to use and dispose of the lands or a portion thereof, but with this we are not now concerned. The construction we give to the granting terms of the act, as qualified by subsequent provisions, not only secures the application of the property to the construction of the road and telegraph line, and thus carries out the purpose of the government, but also secures the company against any attempted alienation of the land to other parties. 11 S.Ct. at 391.

In a related case, St. Paul M. & M. Ry. Co. v. Greenalgh, 11 S. Ct. 395 (1891), a railroad incorporated under the laws of Minnesota was the St. Paul, Minneapolis and Manitoba Railway Company, successor to the St. Paul and Pacific R.R. Co. The quarrel was over certain real estate claimed by the railroad as made by as a part of the Land Grant Act of Minnesota on March 3, 1857. It was pointed out that the railroad's completion was delayed beyond the original completion date. The rights of the company were therefore subject to forfeiture or other hostile proceedings for the breach of the condition attached by law to the grant.

The Court pointed out:

> And it would be in the highest degree inequitable to allow the company to have all the benefit of the extension of time to complete its road, so as to avoid any forfeiture of its privileges and franchises, without at the same time holding it to the conditions affecting the rights of settlers upon the lands of the company, in consideration of which the extension was made. 11 S. Ct. at 396.

The St. Paul, Minneapolis and Manitoba was the ancestor to the Great Northern Railway, which like the Northern Pacific merged to form the Burlington Northern in 1970.

The land grant statute was interpreted further in Northern Pacific Railway Company v. Townsend, 23 S.Ct. 671 (1903). It involved a question of whether the railroad lost title to certain land by adverse possession. The 1864 statute was described as having empowered the N.P. to construct and maintain a continuous railroad. The opening statement by Justice White was that "Section 3 created a large land grant to secure the construction and continuous maintenance of the road. * * * Section 10 secured to all the people of the United States the right to subscribe for its stock." The Court pointed out that the company had signified its acceptance in writing as required by the Act. The railroad was constructed through the land involved in 1870 and 1871. Abner Townsend and George Brown entered homestead notices in 1878 and 1882. The carrier thereafter demanded possession of the quarter section within their granted right-of-way and then brought action for ejectment in the state courts of Minnesota to settle title to the land in Wadena County. The Supreme Court of the United States upheld the right of the railroad and made the following interesting observations:

> On the contrary, the grant was explicitly stated to

> be for a designated purpose,--one which negated the existence of the power to voluntarily alienate the right of way or any portion thereof. The substantial consideration inducing the grant was the perpetual use of the land for the legitimate purposes of the railroad, just as though the land had been conveyed in terms to have and to hold the same so long as it was used for the railroad right of way. In effect the grant was of a limited fee, made on an implied condition of reverter in the event that the company ceased to use or retain the land for the purpose for which it was granted. This being the nature of the title to the land granted for the special purpose named, it is evident that, to give such efficiency to a statute of limitations of a state as would operate to confer a permanent right of possesion to any portion thereof upon an individual for his private use, would be to allow that to be done by indirection which could not be done directly. * * *
>
> To repeat, the right of way was given in order that the obligations to the United States, assumed in the acceptance of the act, might be performed. Congress having plainly manifested its intention that the title to, and possession of, the right of way should continue in the original grantee, its successors and assigns, so long as the railroad was maintained, the possession by individuals of portions of the right of way cannot be treated without overthrowing the act of Congress, as forming the basis of an adverse possession which may ripen into a title good as against the railroad company.

It is clear that the railroad's right to retain the land grnt assets is contingent upon its maintenance of the railroad. Any severance of those assets from the railroad would clearly violate the land grant statute.

The railroad system undoubtedly had a great influence on the outcome of the Civil War. The South erred in making Richmond its capital, and it had very little adequate transportation from that point to the various parts of the Confederacy. The North, on the other hand, had a rather adequate railroad system and indeed transported the necessary troops to make the difference at the climatic battle of Vicksburg. While there was undoubtedly speculation in the railroad industry in the Civil War, and indeed the legendary Rhett Butler was a major dealer in railroad bond business,[5] the major development of the West did not get started until after the Civil War had terminated.

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[5] Gone With the Wind, p. 982-3.

It has been said that whiskey and tea built the West, with the Irish on the Union Pacific building to meet the Chinese on the Central Pacific at Promontory Point, Utah, where the first of many golden spikes was placed on May 10, 1869. The Chinese were paid up to $35.00 in gold a month with up to 9,000 Chinese working for the CP.[6] Compensation to the UP and the CP was somewhat contingent upon the mileage of rails laid, and as the two ethnic groups got closer together, they competed with unannounced dynamite blasts in each other's territories.[7] Thus ended the land grant railroad UP[effort, for which it had lobbied at a cost of $436,000 for the Land Grant Act of 1864.

The Northern Pacific received 57,000,000 acres of land grants over the forest and mineral area of the Northwest.[8] One of the more fascinating efforts was by Jay Cooke, who almost induced the Canadians to run the Canadian Pacific along the south shore of Lake Superior, through Duluth, and then to the northwest part of Canada. That would have given control over development of the Canadian Northwest to the United States. This was in 1871.[9] Cooke was so enthusiastic about his plan, that Duluth became known as Jay Cooke's banana belt. Indeed, a speech which deserves to be memorialized was given by Congressman J. Preston Knott of Kentucky, who spoke in the House on January 27, 1871 and describe Jay Cooke's Duluth as follows:[10]

> The symmetry and perfection of our planetary system would be incomplete without it. I see it represented on this map that Duluth is situated exactly half-way

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[6] High Road to Promontory, Chapter 9, p. 151

[7] The Robber Barons, p. 91

[8] History of the Great American Fortunes, p. 682-683, Gustavus Myers

[9] The Impossible Railway, Chapter 2, p. 43

[10] The Robber Barons, p. 98-99

> between the latitudes of Paris and Venice, so that gentlemen who have inhaled the exhilerating airs of the one, or basked in the golden sunlight of the other, may see at a glance that Duluth must be a place of untold delights, a terrestrial paradise fanned by the balmy zephyrs of an eternal spring, clothed in the gorgeous sheen of ever-blooming flowers and vocal with the silvery melody of nature's choicest songsters * * *.

The Northern Pacific was amply supplied with wealth through the land grant system. Not all, however, was to its liking. And when it received the patent to the top of Mt. Tacoma, with its inaccessible peak, it swapped those worthless lands for the best 2,000,000 acres of mineral, forest, and farming lands in the West.[11] The grants in Minnesota alone would equal double the acreage of the entire state of Massachusetts. In Montana, the grants equaled the entirety of acreage in Maryland, New Jersey, and Massachusetts.[12]

The economic difficulties of the early 1870's provoked the Department of the Army to explore the Black Hills for gold. The original Northern Pacific defaulted in January, 1875, and foreclosure ensued, and the property was sold. At about this time, the St. Paul and Pacific, later the Great Northern, was sold on foreclosure.[13]

By the 1870's, the UP's original investment of lobbying expenses of $436,000 resulted in Government subsidies ranging up to $48,000 per mile, with the land grants going from 20 to 40 miles wide to a total of 12 million acres.[14] The CP going east from the Pacific was granted 9,000,000 acres and $24 million in Government bonds.[15] The UP's construction company, the Credit Mobilier, averaged 74% profit per year.[16] The Illinois Central was built with "12 parts to one by public funds." They charged $48,331 a mile above their receipts or costs, and they sold the land granted to them in amounts up to $35,000,211 per mile. It is estimated the watered stock amounted to $8,189 per mile. They netted $2 million over and above costs.[16(a)]

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[11] History of the Great American Fortunes, p. 233-234

[12] History of the Great American Fortunes, p. 232

[13] The Story of the Western Railroads, Chapter VIII, p. 127-128

[14] History of the Great American Fortunes, p. 441

[15] The Robber Barons, p. 78

[16] The Story of the Western Railroads, Chapter V, p. 80

1877 was a climatic year in railway labor. The burgeoning discontent resulted from a decrease in wages greater than the recession the prices had warranted. The railroad corporations had ignored the comparison of living costs with wages when ordering the wage cut, and many scraped by on corn bread and black molasses.[17] The Boston and Maine had already cut its employees' wages 10 percent when it declared a 6 percent dividend on a surplus. It then, January, 1877, raised the salaries of its president and superintendent. The Brotherhood of Locomotive Engineers demanded a raise of 10 cents a day for the entire property's 67 engineers, a cost of $6.70 per day for the whole road. The BLE stopped the trains, and the periodical The Railway World wrote:

> The result is awaited with much interest, because the failure of the strike will probably lead to the avoidance of future conspiracies against railway companies and the travelling public.[18]

There was no quick breaking of the strike. Finally, President Hayes brought out the troops. For the first time in the history of the United States, the Federal Government intervened in a labor strike.[19] This was the era when,

> The regular compensation of employes covers all risk or liability to accident.
>
> If an employe is disabled by sickness or any other cause, the right to claim compensation is not recognized. Allowances when made in such cases, will be as a gratuity, justified by the circumstances of the case and previous good conduct.[20]

[16(a)] History of the Great American Fortunes, p. 131

[17] History of Neenah, Chapter 1, p. 8

[18] 1877: Year of Violence, p. 34-35

[19] History of Railroad Strikes, Chapter 1, p. 14

[20] 1877: Year of Violence, p.45

Private insurance did not begin until after the strike, and the union brotherhoods began to develop their own insurance programs. The only head to head conflict between Standard Oil and the railway was in the same year, with the Pennsylvania. About the only pipeline that the Rockefellers did not own was the Empire Transportation Company, belonging to the Pennsy. Rockefeller, owning many pipelines and with the other lines and railways friendly to him, Scott of the Pennsy decided to build his own refineries. The resulting rate war was that "oil was carried from the Oil Regions to New York for 8 cents less than nothing." The spreading of the railway strike from the B&O to the Pennsy, and the pitched battles with the strikers, resulted in many deaths and much destruction. Standard Oil in effect won by default when the Pennsy sold the refineries and Empire Transportation to Standard Oil.[21]

The next federal troop intervention was in silver miners' strike at Coeur d'Alene, Idaho, in 1892, when President Benjamin Harrison broke a strike.[22]

Judicial intervention in organized labor began in 1888, when the first labor injunction was issued by a federal court in a strike on the western railway. The injunction was based upon the Interstate Commerce Act prohibition against "conspiracy and restraint of trade." Arrests and trials without jury were conducted, such as in the famous pullman strike of 1894.[23] A planned strike on the Northern Pacific resulted in a scheduled conference. However, United States Senator Spooner, attorney for the carrier, presented a proposed injunction to U.S. Circuit Judge Jenkins, to prohibit the men "from combining or conspiring to quit, with or without notice." It was soon supplemented by a prohibition against the employees "ordering, recommending, approving or advising others to quit the service of the receivers." The U.S. House of Representatives Committee on the Judiciary investigated the matter and found that the injunction was unconstitutional and abuse of judicial power, and unlawful. The injunction, however, had done its damage to the effectiveness of the strike. It had its management casualties also, for Villard was overthrown by a group manipulated by James J. Hill, whose son then became vice-president of the NP.[24]

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[21] Freedom and Organization, 1814-1914, Chapter XXVII, p. 368
22 1877: Year of Violence, p. 319
[23] The Robber Barons, p. 367

Hill, who had brought his Great Northern finally to the Pacific in 1890 and caused bankruptcy of the NP,[25] had secured the old St. Paul and Pacific R. R., under its original name St. Paul, Minneapolis and Manitoba. He changed the name to Great Northern Railroad and claimed, in 1884, 65,000 acres of land in the Dakotas from a land grant of 1857, along the Red River. This area had been developed by the farmers into a great agricultural area.[26] The railroad decided that it wanted the land which it had never sought to enforce for over 40 years, and the net result was a congressional act allowing the carrier to select other, richer lands to the West.

The overbuilding by the railroads was manifested by a 16 month period in 1899-1900, when 16 percent of the railroad mileage was absorbed by other carriers.[27] Montana investigated, along with Congress, the theft of mineral lands by those controlling the NP in that state. Claimed was gold, silver, lead, and copper, and in 1890, the NP received a favorable decision from the Supreme Court of the United States to the effect that although land grant provisions excepted minerals from the land grant titles, that was true only of those minerals known at the time of the grant to be in existence.[28]

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[24] History of the Great American Fortunes, p. 688-689
[25] The Robber Barons, p. 311
[26] History of the Great American Fortunes, p. 680
[27] The Interstate Commerce Omission, p. 73

The Interstate Commerce Act supposedly was designed to foreclose conspiracies and restraint of trade. While we have had a checkered history with the culmination of incompetence in the famous Yak Fat case of recent years, the immediate effect of the Interstate Commerce Act of 1887 and the Sherman Anti-Trust Act of 1890 apparently was the enrichment of attorneys.[29] The great labor leader, Eugene Debs, founder of the American Railway Union, had his first test on the Great Northern. He brought the property down, and when James J. Hill told him that he did not represent these men, Debs then told Hill to send his men back to work if he, Debs, was not representative of their desires. Other forces finally intervened, and an arbitration committee in Minneapolis composed primarily of businessmen rendered a decision that generally favored the workers.[30] Debs once said that "the labor agitator of the early days held no office, had no title, drew no salary, saw no footlights, heard no applause, never saw his name in print and fills an unknown grave."[31] He should have added, however, that he saw an indictment, for the Interstate Commerce Act, designed to foreclose corporate conspiracies was used first against Debs, a labor leader. He was represented by Clarence Darrow, who left the Chicago and Northwestern to represent this idealist.

The Union Pacific, along with 155 other railroads, collapsed in the depression of the mid 1890's.[32]

Bertrand Russell, the great philosopher, wrote:

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[28] History of the Great American Fortunes, p. 684

[29] Freedom and Organization 1814-1914, Chapter XXVII, p. 366

[30] The Story of the Western Railroads, Chapter XVI, p. 253

[31] The American Labor Movement Introduction, p. 2

[32] Freedom and Organization, 1814-1914, P. 505

> The nineteenth century was brought to its disastrous end by a conflict between industrial technique and political theory. Machine production, railways, telegraphs, and advances in the art of war, all promoted organization, and increased the power of those who held economic and political command. Pierpont Morgan and William II could direct human energy more rapidly and more massively than Xerxes or Napoleon or any of the great men of past times. But effective political thought had not kept pace with the increasing concentration of authority; theory, insofar as it had succeeded in moulding institutions, was still divided between monarchy and competitive democracy, the first essentially pre-industrial, and the second appropriate only to the earliest stages of industrialism. Plutocracy, the actual form of government in Western countries, was unacknowledged and as far as possible concealed from the public eye.

The United States was not the only nation with railroad complications and difficulties.

In Canada, Alexander MacKenzie was elected through the Jay Cooke Northern Pacific, but when the NP failed, MacKenzie's political popularity receded.[33] In England, however

> Nothing more strongly illustrates the disadvantages under which an old country, like Great Britain, labours in competing with her younger rival, than to glance at the progress of railroads in the two empires.
>
> At the same time that, in the United States, almost every day beheld a new railway company incorporated, by some one of the States' legislatures, at the cost only of a few dollars, and nearly by acclamation, the British Parliament intercepted by its votes some of the most important projects that[34] followed in the train of the Liverpool railroad.

While the English were able to secure their Turkish and Egyptian bonds through the military, both the Army and the Navy, the English investors lost money on the Erie Railroad with absolutely no possibility of recovery.[35] In the Transvaal, the Dutch retained their farms, even after the discovery of gold, and long delayed the construction of the railway in that country.[36] What had occurred in the United States was the transfer of economic power passed from the industrialists to bankers in 40 years, but in Germany the banks had held power since the beginning of the Industrial Revolution. The banks there held the power because they held the notes, and German banks spread their financing all the way to the Northern Pacific, in 1893. It also had investments in the Turkish Railways and the Berlin-Bagdad scheme.[37] That was the railway which eased the Russians, the French, and the English to disadvantage in the near East, and that advantage was to continue until a compromise favorable to Germany was about to be reached when the first world war erupted.[37(a] The Russo-Japanese War, 1904, resulted in part because the Russians coveted the timber in Korea and built the Siberian Railway and thereby made war feasible in the Far East.[38] The Chinese had been in a quarrel for years with the Japanese, with French and British interests as well. The Germans, with two missionaries in Shantung, obtained as indemnity the Harbor Kiaouchau, with railway rights to the hinterland.[39]

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[33] The Impossible Railway, Chapter 5, p. 116

[34] Freedom and Organization, 1814-1914, Chapter XIV, p. 157

[35] Freedom and Organization, 1814-1914, Chapter XXXI, p. 464 19

Bismarck, who along with Richard Wagner, did more than all other influences to create a German national spirit, desired a nationalization fo the railroads, but in some areas the properties belonged to the empire. Prussia, through his influence, obtained ownership. In 1909, there were 60,000 kilometers of railway in Germany, of which only 3,600 were privately owned.[40] The Prussian Minister of railway did what no American management could ever do. He:

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[36] Freedom and Organization, 1814-1914, Chapter XXXI, p. 471

[37] Freedom and Organization, 1814-1914, Chapter XXX, p. 440

[37(a)] Freedom and Organization, 1814-1914, Chapter XXXI, p. 476

[38] Freedom and Organization, 1814-1914, Chapter XXXi, p. 478

[39] Freedom and Organization, 1814-1914, Chapter XXXI, p. 478

[40] Freedom and Organization, 1814-1914, Chapter XXX, p. 436

> * * * insisted that every railway employee must salute every railway engine when it passes him, since on every Prussian railway engine there is to be seen a Prussian eagle--the 'squashed crow' of the rest of Germany.[41]

Culture was affected by the railroads. Hector Berlioz rode free on the railroad for several years from his country home to Paris. Charles Dickens may be the first case of psychoneurosis from a railroad wreck. While he had had "hypochondrical whisperings" from the 1850's and perhaps before, he was involved in a wreck in 1865 and never fully recovered. Paderewski, the noted pianist and composer and prime minister of Poland, traveled throughout the United States in a private railway car and entertained the railroad crews with his piano practicing in the yards. He had a very severe railroad collision, was substantially injured, missed several concerts, and received a nominal settlement.

The railway industry in Russia contributed to opera. Rimsky-Korsakov got in a dispute with the government Directorate, and he then agreed to have a railway magnate sponsor his opera Sadko. The same company official, Mamontov, produced Mozart and Salieri, by the same composer. The financier, however was sent to jail for "doubtful transactions in connection with Archangel Railway."[42]

The railroad transportation had different ways of affecting operatic personalities. Giusseppe Verdi wrote on 1867 to a friend

> We really are a lot of lunatics! I ask you, was it necessary to travel up and down the railway in order to relieve one's mind after eight months at the Opera![43]

The mad king of Bavaria, Ludwig, insisted on calling for repeated performances of Wagner's Tristan und Isolde. "After the fourth, he returns to Berg in the locomotive of the special train so that the wind and the speed may sooth his overwrought nerves. But his musical appetite will not be appeased."[44]

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[41] When Blood is Their Argument, p. 106

[42] Six Great Russian Composers, p. 163

[43] Verdi, p. 248

The operatic personalities have resulted, however, in only three railway stations named for the opera: Cecchina, near Rome, The Heroine of La Buona Figliola, by Piccinni; Swiss Cottage in London, from Adolph Adam's Le Chalet; and Szep Ilona, and Budapest, Offenbach's LaBelle Helene.[45]

The history of the 19th century undoubtedly influenced Chekhov, who wrote: "What would you say if a newspaper reporter, because of his fastidiousness or from a wish to give pleasure to his readers, were to describe only honest mayors, high minded ladies and virtuous railroad conductors?[46]

The beginning of this century produced a new set of financiers as the successors to Villard, Hill, and Vanderbilt.

J. Pierpont Morgan operated through a series of interlocking direct routes and obtained virtually total control over the Great Northern through Hill, the NP, the CB&Q, the Southern Railway, Central of Georgia, Louisville & Nashville, Reading Central, Erie, Hocking Valley, Lehigh Valley, Santa Fe, St. Louis & San Francisco. Hill and Morgan wanted to round out their transportation system of combining the Great Northern and Northern Pacific with the secret purchase of the CB&Q. That would combine the lumber transportation on the northern part of the railroad West with the CB&Q terminals at Omaha, Chicago, and St. Louis. In 1896 was arranged the massive purchase of NP stock from the public by Hill and Morgan. The stocks soared up to $1,000 a share when the willing stockholders assumed that there would be a bust and they could repurchase later on. Hill and Morgan kept the stock, and when asked for an explanation, Morgan said "I owe the public nothing".

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[44] The Mad King, p. 57-58

[45] How Opera Grew, p. 90

[46] Wrong Job for Pollyanna

Hill formed the general idea for a holding company. He with Morgan launched the project of the Northern Securities Corporation, for Morgan's exaplanation: "My idea was, I can't live forever, and J.P. Morgan and Company may be dissolved. I wanted to put it in a company with a capital large enough so that nobody could ever buy it." The holding company would be capitalized at $400 million, and Hill described it in May, 1901 as follows:

> The cost of administering the affairs of the holding company would be practically nil, as it would only draw dividends on the shares held by it and divide the money so received, by check, to its own shareholders. You will see how strong the holding company would be. It would control the Great Northern and Northern Pacific, and those two roads would control by ownership the Chicago, Burlington and Quincy * * *. It could also * * * hold the shares of coal or other companies which, while of value in themselves and of value to the railroad company for the traffic they would afford, the charters of the railroad companies are not broad enough to enable them to hold with safety. * * * For myself I feel that the future would be secure, and we would have certainty in the situation, and control of these properties safe. Unless we do something of this kind, we will always be subject to attacks like the recent one to secure control of one or other of our properties.

Hill and Morgan then exchanged their shares in Great Northern and Northern Pacific for stock of Northern securities; and the UP representatives did likewise and received shares in the new holding company. By the quirks of fate, one of the adopted sons of North Dakota, Theodore Roosevelt, became president on September 6, 1901 upon the assassination of McKinley. Roosevelt did lead a protest against the trust companies.

As someone from North Dakota said many years ago,

After the locusts we got Jim Hill.

In 1902, Minnesota attacked the trusts, and Roosevelt's attorney general joined in. The Supreme Court two years later ordered a dissolution of the trust, and the railroads had to be separated.

Hill consolidated his investments in the Great Northern and then turned over the presidency to his son, Louis W. Hill.

Jesse J. Friedman and Associates has published a study entitled Federal Aid to Railroads, Part III Grants of Public Lands to Railroads. That study suggests that 223 million acres of state and federal lands have been granted to the railroads, but the land grant railroads have built only 8 percent of the total railroad mileage of the nation. The Burlington Northern's predecessor corporations received 35 percent of all federal lands granted to railroads. Land grants to railroads constituted 24 percent of Minnesota, 24 percent of North Dakota, 16 percent of Montana, and 1 percent of South Dakota. Friedman reports that in 1924, Congress investigated the Northern Pacific land grants and found that the NP had sold land grant land for $136 million, and the road itself did not cost more than $70 million to construct; that the NP had failed to construct 1,500 miles within the time requirements; that the NP had failed to sell some of its lands at $2.50 per acre or less, had failed to sell thousands of acres at public sale as required; that the NP had received by error 640,000 acres apparently by reason of the Tacoma problems; that it had received 600,000 acres to which it was not entitled near Wallula; the NP had transferred thousands of acres of valueless land and received valuable lands in 7 states.

Friedman points out that the 1940 Omnibus Transportation Act repealed the requirement of the land grant railroads to grant rate reductions for the movement of mail and federal government property. In 1946, the land grant preferences for movement of government military property terminated by act of Congress. The Friedman study says:

> One of the most important aspects of the controversy over repeal of the land-grant rates on government traffic was the contractual origin of the obligation which had been assumed by the railroads at the time they petitioned for, and received, vast areas of the public domain. There was no time limit placed on the duration of the rate concessions that grant-aided railroads agreed to provide. In essence, the government and the railroads made a bargain under which the government granted the lands and the railroads agreed to live up to the terms of the grants, one of which was to carry government traffic free or at reduced rates over the railroad lines built with the aid of the grants--as well as with financial and other aids--and to do so in perpetuity. P. 49.

In 1942, Congress considered a bill to reconvey to the government the land grants if the railroads abrogated the contracts. Congressman Everett Dirksen opposed it unless there was an equitable procedure for the conveyance of the land to the federal government. Congressman Leavy of Washington pointed out that the NP at that time owned 5.6 million acres of land grant land and had disposed of millions of acres. He said "to relieve the railroad company of this responsibility to haul government freight and passengers and yet permit them to keep the consideration is indefensible". Friedman Study, p. 52. Congress, however, did not attach any conditions regarding the return of unsold lands when it finally repealed the land grant concessions in 1945. I know of no legislation that has terminated the obligation of the railroads to keep their assets obtained by land grants for the development of the railroads in the movement of passengers and freight.

Perhaps it is my Irish background, but I find that the Burlington Northern is a dear and old friend. I worked for the Great Northern as a section hand many years ago, and I have been in relatively constant litigation with the Burlington Northern since its merger on March 3, 1970. Perhaps it is the Irish spirit that "tis better to be quarrelsome than lonesome".

THE INTERSTATE COMMERCE ACT AND MERGERS

The Hill Reference Library in St. Paul, Minnesota, produces an emormous amount of information about the history of the railroads, the history of the Interstate Commerce Act, and the history of mergers and development of holding companies.

Railroads existed for some 57 years, at least, in the United States before any federal statute was designed and enacted to impose any type of control. There is, of course, no precise date for development of a substantial amount of interstate railroading. The railroads started developing at least by 1830 and involved many state statutes enacted before actual receipt of corporations capable of constructing the lines.

The first general period would be before 1887, the year when the Interstate Commerce Act was enacted. By 1850, for lack of any effective competition, the success of railroad transportation "seemed assured." (Caudill, p. 13). Perhaps the first merger occurred in 1853 when ten carriers formed the single railroad between Albany and Buffalo and named the new company the New York Central. (RLEA, p. 8) Minnesota enacted a statute in 1856 to incorporate the Minneapolis and St. Cloud Railroad Company, which was thereby empowered to acquire property and to connect with any railroad. That corporation later on invoked that statute, unsuccessfully. Pearsall v. Great Northern Ry. Co., 16 S.Ct. 705 (1896).

The Civil War certainly expanded the potential by manifesting the need for the railroad system. The federal government became active in the promotion of the national transportation system. While hardly the first statute, Congress on July 12, 1862 authorized

Minnesota to aid in the construction of a railroad from Stillwater, through St. Paul, to St. Anthony, then to Big Stone Lake. On July 2, 1864, Congress chartered the Northern Pacific Railroad Company, named persons erected thereby into a body corporate, and made specific authorizations which have been referred to elsewhere in this testimony. On March 3, 1865, they increased the 1857 allotment of lands to ten sections per mile for each of the railroads involved. Chapter 105, 38th Congress, 1865. The Green Bay and Lake Pepin Railway Company was authorized to build across the Oneida Reservation in Wisconsin, and on the same day, March 3, 1871, the St. Paul and Pacific Railroad Company was allowed to order its branch lines to enable it to intersect with the Northern Pacific, dependent however upon approval by the Minnesota Legislature and a release of all land along the abandoned lines involved in the transfer. Chapters 100 and 42, 144, 41st Congress, 1871.

The early consolidations were of the end to end type, rather than those reducing competition along parallel lines. (Jacobson, p. 30.

The major incident producing a great system of combinations and construction was the depression period of 1873-1893. (Caudill, p. 14). The first transconctinental railroad, the Union Pacific, had already connected with the Central Pacific by that time, that is May, 1869.

From the 23 miles of railroad in 1830, the industry expanded to 30,626 miles in 1860. (FRA, p. 53). There were approximately 100,000 miles by 1880. The continuing expansion of the railroad, with the recurring mergers and the potential for rebates and exploiting charges, the 1870's saw the promotion of the Granger Laws in the various states in the Midwest for the purpose of setting maximum rates on railroad service and railroad owned elevators and warehouses. (FRA, p. 56).

Congress finally considered the railroad industry from the standpoint of controls, primarily because of the evils of the rate discrimination. (Daniels, p. 52). The bill was introduced by Senator Cullom in 1886, and Congress enacted the Interstate Commerce Act and established the Interstate Commerce Commission on February 4, 1887. 54 Stat. 379, Chapter 104. This act did not empower the new ICC to deal at all with consolidations. (Caudill, p. 14) It dealt primarily with proscription as rebates, Section 2, unreasonable preferences or advantages, Section 3, the extension of equal facilities, Section 3, and the pooling of freight of different and competing railroads or the division the aggregate or net proceeds of the earnings of the railroads. Section 5. It was, obviously, a response to the Granger movement and an attempt to set up the ICC as a regulator of claims between the shippers and the carriers. An amendment on March 2, 1889 required that the carriers print and keep schedules and impose criminal sanctions for willful violations.

The federal government first indicated an interest in the competitive aspects of this railroad system by the Sherman Antitrust Act of 1890. 26 Stat. 209, Chapter 647. That Act declared illegal every combination in restraint of trade or commerce among the several states or with foreign nations. The first case before the Supreme Court resulted in a dismissal of the Complaint because the defendant's sugar refining was restricted to the Philadelphia area and bore no relationship to commerce between the states or foreign nations. United States v. E. C. Knight Co., 15 S.Ct. 249 (1895). The next case resulted in a finding for the defendant on the grounds that the cattle dealers organization there was open to whoever desired to join. Anderson v. United States, 19 S.Ct. 50 (1898).

While the Supreme Court in the 1890's was not particularly effective at enforcing the Sherman Anti-Trust Act of 1890, the Great Northern had finally gotten to the Pacific Coast, in 1895, and the Northern Pacific was insolvent. This was in the 15 year era, 1893 to 1908, that was the greatest consolidation development in American Railway History. (RLEA, p. 3). The developments involved, because of the Sherman Anti-Trust Act, operating contracts, holding companies, interlocking directorates, and community of interest. Ibid.

Hill's Great Northern, changed to that name in 1889, was a beneficiary of a wealthy land grant through its predecessor companies. The Minnesota and Pacific R. R. reported land grants of 2,457,600 acres at $8.00 per acre, which worked out to $40,720 per mile of railroad. Hill, however, received no lands west of the Minnesota-Dakota border. (Thompson, p. 55). Of these acres, Hill reconveyed 64,117.92 acres and selected alternative lands in the amount of 59,140.12 acres. Ibid. Of the Great Northern's predecessor corporations, eleven received substantial gratuities from Minnesota. The First Division St. Paul and Pacific R. R. received $7,487,625.89 in congressional lands, and its branch line received $1,735,122.70. Its St. Paul and Pacific R. R., St. Vincent extension, received $7,187,883.88. The Minneapolis and St. Cloud R.R. received $303,049.58. The First Division branch line received graded road bed of the value of $156,250 and bonds of $600,000. The subdivisions contributed a total of $396,205. Ibid. All of these land grants and gratuities were received before 1883, except for $60,500 received in 1890 and 1891. The public gratuities of $17,869,137.05 averaged out to $17,075.95 per mile. Ibid.

The 1890's introduced the Great Northern and the Northern Pacific to the Supreme Court, on almost a regular basis. In St. Paul and P. R. Co. v. Northern Pacific R. Co., 11 S.Ct. 389 (1891), the Northern Pacific sued to establish title to land in several sections, thousands of acres, near Glyndon, Minnesota. The claim, of course, was based upon the land grant statute of July 2, 1864. The general designation of the land was designated in 1869, and the joint resolution in Congress in 1870 indicated 20 mile limit for lands in place, 30 mile limit for indemnity lands, and the 40 mile limit for the other indemnity lands added by the joint resolution of 1870. The state, however, did not have the amount of lands intended to be conveyed by the act of Congress, and to make up the deficiencies, the Northern Pacific was to take land from the 40 mile limits. The conflict occurred because the defendant St. Paul cited the congressional act of March 3, 1857, 11 Stat. c. 99, p. 195, whereby the territory of Minnesota granted certain lands to the St. Paul to aid in construction of a railroad from Stillwater, to St. Paul, to St. Anthony, to Big Stone Lake, to the navigable waters of the Red River. That land had been conveyed to the Minnesota and Pacific R. R. Co. by the Minnesota legislature on May 22, 1857. The M & P located its main line of its railroad and in 1858 executed a mortgage on the railroad. The mortgage was foreclosed, the property was sold, and the State of Minnesota became the purchaser. In March, 1862, the legislature enacted a statute granting the rights to the St.Paul and Pacific R. R.Co. In July, 1862, Congress passed a resolution granting to that railroad lands in lieu of the 1857 grant. It was held that the Congress, by enacting a statute, 13 Stat. c. 105, p. 526, on March 3, 1865, extended the time for the completion of the land grant railroads in Minnesota and Iowa. The net result was that the

Northern Pacific had had priority and right to subsequent designations of lands granted to the St. Paul and Pacific. In a case decided the same day, St. Paul M. & M. Ry. Co. v. Greenalgh, 11 S.Ct. 395 (1891), the St. Paul, Minneapolis and Manitoba Ry. Co. brought action against Greenalgh, who had obtained a patent to certain land. The carrier contended that it had obtained title on March 3, 1857 by the statute conveying to the St. Paul and Pacific R. R., to which it had succeeded. The defendant settled on the land on June 26, 1872, after the map locating the property as belonging to the carrier had been filed with the Secretary of Interior. Greenalgh settled on the land and made improvements thereon. The statute of June 22, 1874 extended time for the St. Paul and Pacific to complete its road on or before March 3, 1876 and "no longer." The road was completed in November, 1878. The Court held that the rights granted to the carrier were subject to forfeiture for breach of the condition. The Court held that:

> And it would be in the highest degree inequitable to allow the company to have all the benefits of the extension of time to complete its road, so as to avoid any forfeiture of its privileges and franchises, without at the same time holding it to the conditions affecting the rights of settlers upon the lands of the company, in consideration of which the extension was made. 11 S. Ct. at 396.

Another case held that the lands granted to the Northern Pacific could be protected by litigation if the State of Washington or the City of Tacoma or anyone else took measures to establish anything affecting the granted title or rights. Prosser v. Northern Pacific R. Co., 14 S.Ct. 528 (1894).

An interesting case is Pearsall v. Great Northern, 16 S.Ct. 705 (1896), where Pearsall, a shareholder sought to enjoin an arrangement affecting the bonds and mortgages of the Northern Pacific. The defendant Great Northern had been organized from the original Minneapolis and St. Cloud R. R. Co. of 1856 under the territory of Minnesota. That statute authorized the M. and St. C. to connect with any railroad running in the same direction. The Northern Pacific at the time of the litigation was insolvent. The GN and the majority shareholders of the NP agreed to sell the property to a committee of bondholders who would form a new corporation whose loan would be guaranteed by the Great Northern. Pearsall contended that this was a consolidation of stock in violation of Minnesota Statutes. The issue was whether the original charter to the Minnesota and St. Cloud, empowering it to connect with any carrier, could be rescinded. The court held on the basis of the classic Dartmouth College case that the road had not been carried out and implemented before the enactment of the legislation of 1874 by Minnesota whereby the railroads were barred from consolidations. The decision would have gone the other way apparently if the extension had been accomplished before the 1857 statute had been amended. It is, however, illustrative of the innovations which the Great Northern used so many times, and in this case it was unearthing almost an ancient statute of its remote ancestor, a statute in conflict with subsequent enactments which proscribed the very thing which it had planned to do.

Consolidations continued through the 1890's. Actually, by 1890, within 16 months 16 percent of the nation's total mileage had been absorbed by other lines. (Caudill, p. 15). The 14 years following the Sherman Anti-Trust Act of 1890 resulted in no contest to the consolidations. The ICC, of course, had no authority under the Interstate Commerce Act to bar any monopolistic combine.

James J. Hill as early as 1889 indicated an interest in purchasing controlling interest in the Northern Pacific. By 1895, the NP was in receivership. (Daggett, p. 199). Although there were several proposals for an arrangement between the GN and the NP, there was a final agreement by Hill of the Great Northern, J. Pierpont Morgan, the Deutsche Bank representing German interests, and E.D.Adams, chairman of the NP. Under this proposal, the Great Northern guaranteed the payment of an issue of Northern Pacific bond amounting to $100 million with interest up to $6,200,000 per year. The NP would transfer half of its stock to a Great Northern designee, would join with GN in providing facilities for interchange of cars and traffic, and GN would have the right to route its traffic on the NP property over areas not reached by the Great Northern. This proposal was abandoned by reason of the decision in Pearsall v. Great Northern, but the plan merely required modifications. Hill obtained $16 million of Northern Pacific's stock, and his close ally J. Pierpont Morgan headed the board of five voting trustees exercising the power of common and preferred stock vote in the NP for five years. By May, 1901, Hill and his associates held $18 million and J. P. Morgan $7 million of NP common stock. (Daggett, p. 201-202).

The Great Northern and the NP in 1901 purchased 97 percent of the stock in the Chicago, Burlington & Quincy; and in November of that year, they created the Northern Securities Company. That holding company obtained control of both the GN and the NP by exchanging its shares of stock for shares in those two carriers. (Phillips, Washington Law Review, p. 4).

The governors of various interested states met. Minnesota, and most of the other states, had anti-consolidation laws. The governors met in Helena, Montana, on December 31, 1901 and adopted a resolution opposing the consolidation of the Great Northern, Northern Pacific, and Burlington Railway system as being in violation of their respective state's laws. On January 7, 1902, Attorney General Douglas of Minnesota requested leave of the United States Supreme Court to file a complaint against the Northern Securities Company. The Court turned down the request by reason of the absence of the two railroads as indispensable parties and held that Northern Securities by itself was not adequate. Minnesota then filed a claim in Minnesota State Court on the basis of the Sherman Anti-Trust Act. Nothing apparently was done about that particular lawsuit, but Minnesota then sued the Northern Securities Company in the United States Circuit Court for the District of Minnesota. It attacked the consolidation of the two carriers on the basis of the Minnesota Anti-Trust Statutes. The Supreme Court held that the matter never should have been filed with the United States Circuit Court because it was not based on the federal statute, which had to be prosecuted by the United States Attorney General. Minnesota v. Northern Securities Company, 24 S.Ct. 598 (1904).

The federal government was vitally interested in Northern Securities, and the ICC adopted a resolution on December 20, 1901 in respect to consolidations and combinations. The United States Attorney General Knox announced on February 19, 1902 that he thought that Northern Securities violated the Sherman Act of 1890, and he filed suit shortly thereafter against the Securities Company and the two carriers. One of the defenses was that Northern Securities was not a railway company and would not come under the Sherman Act because it was only a holding company. (Meyer, p. 242-271). It cited that Pennsylvania Railroad Company in 1870 created a holding company in Pennsylvania. (Meyer, p. 267). It cited perpetual leases and other devices in existence at the time of the enactment of the Sherman Anti-Trust Act. It cited the leases of parallel and competing lines as far back as the 1840's in Northeast United States. It argued, of course, that the Sherman Anti-Trust Act does not relate to either holding companies or railroad companies.

The Supreme Court's decision was rendered on March 14, 1904. Northern Securities Company v. United States, 24 S.Ct. 436 (1904) Justice Harlan wrote the opinion and made some significant observations. He pointed out that the GN and the NP controlled about 9,000 miles of track and that by 1893, the NP had become insolvent. Before the foreclosure and sale, the bond holders agreed with the GN for consolidation of the two systems, which was declared in Pearsall v. Great Northern to be illegal under Minnesota Statutes. Then, in 1901, the GN and NP put their two systems under common control and purchased the capital of the CB&Q. Hill and the Great Northern and Morgan and the NP stockholders formed the New Jersey Corporation, a holding company, Northern Securities. The effect was to convert the interest of the individual shareholders into an interest in the holding company, not the carriers. From Hill and Morgan, Northern Securities received a controlling amount of capital stock of the two carriers. The holding company received additional stock by issuing its own stock in exchange and ended up with substantially all capital stock of the NP and controlling stock of the GN. The allegation was that the carriers had incorporated Northern Securities in bad faith and solely to incorporate the pooling of stock of the companies. The Supreme Court ruled in this landmark decision that this holding company arrangement resulting in a consolidation of two competing carriers violated the Sherman Anti-Trust Act. The Northern Securities was then ordered dissolved. What resulted was a distribution of the NP and Great Northern shares in proper proportions to the Northern Securities shareholders, which of course continued the common allies in control of the two carriers. (Conant, p. 44).

The Elkins Act penalizing every departure from published rates as an unlawful rebate was enacted in 1903. The Hepburn Act empowered the ICC to fix maximum rates for service. (Daniels, p. 53). The era after the Northern Securities case was one of prohibiting consolidation. (Caudill, p. 20). The ICC made an investigation into the Union Pacific in 1907. The Union Pacific had acquired control of the Southern Pacific by purchase of 46 percent of its stock, and the SP was a sea route from New York to New Orleans and then railroad from New Orleans to California and Oregon. The UP extended from Omaha to Utah and then to Portland. The Department of Justice contended that competition had been restrained by the combination. The Supreme Court ruled that there was a severe economic power of the Harriman interests and the Union Pacific and struck down the combination. United States v. Union Pacific R.R., 226 U.S. 61 (1912).

A continuation of the anti-monopoly mood resulted in the Clayton Act of 1914. It held in Section 6:

> That the labor of a human being is not a commodity or article of commerce. Nothing contained in the anti-trust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purpose of mutual help * * *.

The statute barred in Section 2 any price discrimination, in Section 7 the acquisition by one corporation of stock in another. By Section 11, authority to enforce Sections 2 and 7 with respect to common carriers was vested in the ICC.

Up to 1920, anti-trust laws were strictly enforced against railroad consolidations. Conant, p. 48, writes that

> The passage of the Interstate Commerce Act and Hepburn Act was public recognition that competition could not be expected to operate in its usual automatic way in the railroad industry. Yet the railroad anti-trust cases were all won by the government without any proof of abuse of monopoly power and, in most cases, without substantial evidence that the merging railroads ever had been or could be made competitive.

World War I caused President Wilson to exercise emergency war powers and take control of the railroad system. While the railroad system was operated by the Government, the wage increases were substantial, and work rule changes added the number of employees. Labor received 55 percent of the revenue dollars in 1920, when the railroads were returned to private ownership, as compared to 40 cents in 1917. As to the need for nationalization, Caudill, p. 21 writes:

> The Interstate Commerce Commission cannot be absolved from a large measure of reasponsibility for the conditions of the industry which, even though monopolistic, appears to have been beset by serious labor problems, deterioriating plant, and relatively poor earning power at the onset of World War I. After the declaration of war, it took less than six months for the transportation situation to deteriorate to the point where a Government take-over became necessary.

The Congress returned the railroad industry to private ownership by the Transportation Act of 1920. That legislation established a mandate to planned consolidation of American Railroads into a limited number of systems. The ICC was to prepare that plan, although it should retain competition. The Act provided for consolidations if "the public interest be promoted." The Commission was empowered to approve and authorize those acquisitions, and it had jurisdiction of a consolidation of two or more carriers into one corporation.

The Transportation Act exempted consolidations approved by the ICC from other anti-trust proscriptions. Indeed, the ICC shortly thereafter authorized continuance of control by a carrier although the Supreme Court had already held that such control violated the Sherman Anti-Trust Act. United States v. Southern Pac. Co., 259 U.S. 214 (1922), control of Cent. Pac. by Southern Pac. 76 ICC 508 (1923).

The railroad still was almost beyond effective competition. Intercity Truck Transportation, from 1918, barge transportation, from 1920, and air transportation from 1926, gave slow and belated intermodal competition. The ICC had written in 1907, "competition between railways as well as between other industries is the established policy of the nation." Consolidations and common combinations of carriers, 12 ICC 277, 305 (1907). (Phillips, p. 5).

The Transportation Act imposed consolidation of railroads as a national policy. Pursuant to the statute, the ICC published that plan, in 1929. Of those 21 independent systems planned for by the ICC, none had been materialized by 1962. (Phillips, p. 7-8). Part of the proposal was to break up the Great Northern, Northern Pacific, Burlington combination to increase competition in the Northwest. (Daggett, p. 211). It was proposed that the Milwaukee Road would be combined with the Great Northern to equalize the financial strength. (Daggett, p. 211).

The ICC in 1930 considered another attempt by the Great Northern to combine. It allowed the Spokane, Portland and Seattle, the Great Northern, and the Northern Pacific to be controlled by the new corporation, Great Northern Pacific Railway, but the Burlington had to be divorced from control, a feasible plan had to be developed for the acquisition of the short lines, and the Milwaukee Road had to have thorough access from Spokane to Portland over the property of the SP&S. Great Northern Pacific Railway Co. Acquisition, 162 ICC 37, 69-70 (1930). See Daggett, p. 217. This decision, of course, was affected by the 1929 announcement of the ICC's general plan for consolidations reported in accordance with the Transportation Act of 1920. The Burlington having been excluded from the GN and Northern Pacific merger turned its interest to the South and developed its Colorado and Southern, which it had purchased 1908. This provoked the alliance between the Burlington and the Missouri, Kansas and Texas, a part of the ICC plan of 1929. The Frisco and the Rock Island had indicated that they would consolidate, while the Kansas City Southern and the UP were recommended by the ICC's plan. (Daggett, p. 226).

The proposed merger of the GN and the NP was withdrawn, and the presidents of the carriers, Charles Donnley of the NP and Ralph Budd of the GN said:

> The rail situation in the Northwest needs relief. The rail carriers have already made virtually all progress practicable in the direction of increased economy and efficiency. The only way to obtain still further economy and efficiency is through railroad combinations which will not interfere with the preservation of ample rail competition. Daggett, p. 229.

The era of 1907 to 1930 was the maximum expansion ofthhe railroad industry. It had the largest number of operating railroads, 1,564; the greatest mileage of railroad property, 254,251; largest number of passengers, 1,269,913,000; employment was the maximum at 2,076,000; with 69,486 locomotives, 2,414,083 freight cars, 65,763 passenger cars, total trackage operated at 429,883. President Hoover in his annual report in 1929 said that "as a whole the railroads were never in such good physical and financial condition, and the country has never been so well served by them." (FRA, p. 59-60).

The advent of intermodal competition has caused the declining market of the railroad since 1930. The share of intercity freight was over 78 percent in 1929 and was reduced to 36.2 percent in 1976. (FRA, p. 61). Passenger revenue was 14 percent in 1929, and 1.8 percent in 1976. Railroad line mileage has been reduced 21 percent from 1929 to 1976. Locomotives have been reduced 52 percent, freight cars, 35 percent. (However, the increased capacity of the freight cars offsets the reduction in numbers). (FRA, p. 72).

"The overall decline of the railroad industry has occurred despite an increase in both freight tonnage originated and revenue ton-miles." (FRA, p. 72). Revenue tons originated increased 5 percent from 1929 to 1976, but the revenue ton miles increased 78 percent. (FRA, p. 74). In that period of time, net railroad investment fell 72 percent, from $72.6 billion in 1929 to $20.1 billion in 1976. In 1929, non-operating income was only 22.3 percent of the total income, by 1976 it was 60.9 percent. (FRA, p. 76). Cash on hand was $1.6 billion in 1929 and $66 million in the later years. (FRA, p. 82).

The 1930's and the Great Depression resulted in fiancial distress, but also additional legislation.

The Emergency Railroad Transportation Act of 1933 eliminated any compulsory consolidation and imposed labor protective clauses. The statute granted control to the ICC over holding companies, over corporations not a carrier and controlling twoor more carriers through stock ownership. This gave the ICC control over the indirect unification of carriers. (Conant, p. 50). It has been said that:

> The amendments of the Emergency Railroad Transportation Act of 1933 were the final chapter in the two decades of regulation under the Transportation Act of 1920. The changes in the law relating to unification of carriers operated more than anything else as impediments to combinations. Consolidations and acquisitions of control were united in a new Section 5(4), which established two tests for Commission approval: harmony with the ICC general plan of consolidation; and promotion of the public interest. Requiring mere acquisitions of control to conform to the plan of consolidation--the innovation of this statute--established another barrier to such acquisitions. In addition, holding-company control of railroads was for the first time brought under control of the Commission, and Section 7 of the 1933 Act gave such guarantees to railway labor against any loss of jobs resulting from consolidation or coordination programs that many of the potential savings from such programs were eliminated. Conant, p. 57.

The expediency of the 1933 Act is understandable, and the economic depression became more extreme. By 1937, receivers or trustees operated 70,884 miles of railroad. By January, 1938, they operated 79,000 miles. (Caudill, p. 31).

Leading up the Transportation Act of 1940, several court decisions deserve mention. In United States v. Reading Co., 253 U.S. 26, 40 S.Ct. 425 (1919), the Supreme Court considered the holding company which owned and controlled both the Reading Railway Company and several coal companies. The subsidiaries had each one stockholder, the holding company; and the earnings were distributed not in proportion to the shares of their capital stock but rather to the creditors and shareholders of the holding company, with a debt of $135 million and capital stock of $140 million. The holding company therefore pooled the property, activities, and profits of the companies. The holding company in 1898 acted to foreclose the construction of an additional railway for independent miners and coal shippers. In 1900, the holding company made agreements with the independent producers along its line for the purpose of eliminating competition. It then purchased the capital stock of the Central Railroad Company, which owned a subsidiary having control of 14,000 acres of coal bearing lands. The issue was whether the combining into the holding company the ownership of the stock of the carrier and the coal company involved a community of interests within the proscriptions of the commodity clause of 1906, 34 Stat. 584, 585. The Supreme Court dissolved the corporate structure with the following words:

> It results that it may confidently be stated that the law on this subject now is that while the ownership by the railroad company of shares of the capital stock of a mining company does not necessarily create an identity of corporate interests between the two such as to render it unlawful under the commodities clause for the railroad company to transport in interstate commerce the products of such mining company, yet where such ownership of stock is resorted to, not for the purpose of participating in the affairs of the corporation in which it is held in a manner normal and usual with stockholders, but for the purpose of making it a mere agent, or instrumentality of department of another company, the courts will look through the forms to the realities of the relation between the companies as if the corporate agency did not exist and will deal with them as the justice of the case may require. 40 S.Ct. at 434.

At the request of President Coolidge in 1924, Congress studied the Northern Pacific land grant because of the report by the President along the following lines:

1. The sale of granted lands amounted to $136 million, which is 66 million over the cost of road construction; the NP failed to construct 1,507.21 miles of railroad within the time requirements; the NP failed to dispose of acreage at the maximum lawful price; the NP returned thousands of acres of poor land erroneously classified as mineral and acquired mineral indemnity rights therefor; the NP had acquired 1.5 million acres of land in Washington over its entitlement; the NP received 640,000 acres erroneously because

of the Tacoma overlap; the NP had received 600,000 acres over their entitlement because of the Wallula overlap; and the NP pursuant to the Mt. Rainier Park Act of March 2, 1899 returned to the United States thousands of acres of useless land and received privileges for the finest lands in Oregon, Washington, Idaho, Montana, North Dakota, Minnesota, and Wisconsin. (Friedman,p. 19-21). Congress then directed the Attorney General to institute action to clear the claims and titles. The decision was rendered in 1940. United States v. Northern Pac. Ry. Co., 311 U.S. 317, 61 S.Ct. 264 (1940). It remanded the matter to the district court. The original district court order found that the railroad was entitled to compensation for 1,453,000 acres of lands and patents to an additional 429,000 acres. The Government was entitled to compensation for 66,000 acres of land erroneously patented. The Supreme Court affirmed those findings and remanded the matter to the district court for the determination of claims of railroad fraud and breach of land grant. Its stake was the Government's claim on the basis of fraud to 1,000,000 acres of land. The Government and the NP then settled the matter under which all claims were dropped, the fraud and damage charges were eliminated, and the railroad consented to a small money judgment.

The Transportation Act of 1940 was a product of several committees established by President Roosevelt in the late 1930's. The Emergency Railroad Transportation Act of 1938 established that the tests for consolidations were harmony with the ICC general plan of consolidation and promotion of the public interest. (Conant, p. 57). Holding companies were then under the control of the ICC, and employees were protected against loss of jobs as a result of consolidation.

The 1940 Act eliminated the ICC plan for consolidation as one not feasible. It continued the control over consolidations and acquisitions but eliminated the 1920 criterion of preserving competition. (Conant, p. 58). It is subject to at least the following criticism:

> The wording of the Act is sufficiently ambiguous to raise serious question as to its effectiveness as a statement of national policy. For example, there is a considerable amount of room for argument as to the full extent of the change in Commission responsibility regarding consolidations intended in the change of wording in Section 5 which formally required that the Commission find that a proposed consolidation would 'promote public interest' and the language of the 1940 Act which requires that the Commission find that the proposed transaction 'be consistent with the public interest.' Within the two sections there is room to ponder the change intended with the language change from 'may enter an order' of the previous law to the 'shall enter an order' of the 1940 law. Further, the preamble, if taken literally, charges the Commission with an impossible task. Fair and impartial regulation of the several modes may well conflict with the effort to preserve the inherent advantages, even if the regulation were applicable equally to all modes, which it is not. This lack of clarity and inconsistency of content with stated intent will probably require further legislation or else the meaning of the Act will be determined by the courts.

That 1968 criticism by Caudill, p. 38-39, is the minimum criticism that can be directed at the consolidation provisions of the 1940 Act.

Conant writes further, p. 68, that:

> The anti-trust exemption for railroad consolidations or acquisitions of control approved by the Commission, enacted in 1920, marked the turning point in Governmental policy in the direction of favoring consolidations and lessening the barrier of the anti-trust laws. The Emergency Railroad Transportation Act, 1933 and the Transportation Act, 1940, by eliminating preservation of competition as a specific statutory consolidation criterion, marked a further step in the same direction. But the preservation of competition as an element in the public-interest concept still looms as a weakened but possibly significant factor to block railroad

consolidations.

The public interest does not seem to be an effective standard for blocking consolidations. The current rash of railroad mergers dates from the 1957 consolidation of the Louisville and Nashville Railroad with the Nashville, Chattanooga, and St. Louis Railway, according to the ICC report of 1962, p. 4. The December, 1961 issue of Modern Railroads is quoted by RLEA, p. 2, as reporting:

> Current merger fever has swamped ICC with more merger applications--61 on file for fiscal year ending June 30, 1961--than in any of the Commission's past 75 years. Pending applications involve some 108,000 miles of the nation's total rail mileage of 218,000.

The ICC in 1977 published Railroad Conglomerates and Other Corporate Structures. It reported that in 1974, 27 Class I railroads were owned directly or indirectly by holding companies. (P. D1). The study listed major incentives for conglomerate holding companies:

1. Tax advantages;
2. Risk spreading;
3. Eliminating cyclical fluctuations;
4. Improving technology; and
5. Economy in advertising, management, and raising capital.

The two major disadvantages were:

1. Dissipation of assets;
2. Lack of economy of scale and organization.

(P. 5-6)

Class I railroads owned by parent holding companies amounted to assets of $19 billion and constituted 52.3 percent of the Class railroads in those assets. Railroads that are Class I and not owned by holding companies had assets of $8.8 billion, a total of 24.1 percent of Class I assets. The principal railroads not owned by holding companies were listed as the Frisco, the Norfolk and

Western, Burlington Northern, and Southern. (P. 7-9). The Commission is fully informed of the results which have occurred. It said:

> In short, the holding company concept effected two material changes; the railroads lost many of their non-transportation assets and operations including the income therefrom, while the holding companies escaped regulation under Section 20a. (P. 10).

The Commission said that "alleged benefits to the railroads from the formation of the holding companies are supported by little evidence." P. 10.

The ICC apparently wrote the basic steps for what the BN actually did in forming its holding company to eliminate minority stockholders. It said:

> However, to effect substantial transfers of assets from the railroad without being liable to derivative suits by railroad stockholders who did not accept the exchange offer, a further step became necessary. The holding company would form a new corporation, also nominally capitalized and 100 percent owned by the holding company, and then merge it with the railroad. A condition of the merger forced minority stockholders to exchange their railroad stock for that of the holding company or accepted payment for their stock at a price, based on appraisals, set by the holding company's management. P. 11.

The ICC seemed to acknowledge that a railroad's capabilities may be affected by the corporate structure. It stated:

> The Interstate Commerce Act as now written requires prior Commission approval of the acquisition of control over a regulated carrier only if the transaction would result in the common control of two or more carriers. It is our conclusion, based on the results of the investigations and studies conducted for the purpose of preparing this report, as well as our many years of regulating the surface transportation industry, that the services of this country's major railroads are too important--and that the potentials for abuse are too great--to permit the transfer of control over any one major railroad to be accomplished without appropriate regulatory agency approval. (73) * * *
>
> [W]e recognize that the extent of the authority which the Interstate Commerce Act now gives us to investigate the activities of the parents and affiliates of regulated

carriers has not as yet been thoroughly tested. P. 74.

> We believe, however, that we possess the power under the Act to obtain information about any specified suspected abuses, such as property transfers without adequate compensation, the payment of excessive dividends and cash or property, and unconscionable contracts for management or other services. P. 74.

The Commission's own reports to Congress demonstrate beyond any question that the Commission is aware of how fraught with abuse the holding company structure is for the continued prosperity of operating railroads. Yet, the ICC fails to discharge its duty, mandated by Congress, to preserve the railroad industry, protect the railroad assets and protect the public interest.

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THE NATURE OF ICC JURISDICTION OVER SINGLE, INTEGRATED SYSTEMS IS CAUGHT BETWEEN THE ICC AND THE COURTS.

While Section 11348(a) of the Interstate Commerce Act empowers the Commission to assert control over a person owning a carrier, Section 11343(a) mandates all control over any person which is not a carrier but which acquires control of at least two carriers. The ICC should have asserted jurisdiction directly over all facets of the Burlington Northern holding company and should have investigated to determine that there is not an integrated system by rail under the full control and domination of the Burlington Northern.

The joint application for merger stated on page 29 that "all assets and businesses of the Frisco will vest in B.N., and B.N. will assume all the debts, liabilities, and other obligations of the Frisco." In a verified statement attached to the application, Lewis W. Menk, Chairman of the Board and Chief Executive Officer stated on page 35 that "the merger plan of the B.N. and the Frisco has been soundly conceived, carefully studied and planned for, and represents an effective approach by the two railroads to ensure that we have the financial resources necessary to continue to provide high quality rail service to our shippers while at the same time assuring that we have the traffic and resource base necessary to the provision of secure employment opportunities for our employees."

In Alleghany Corp. v. Breswick & Co., 353 U.S. 151, 77 S.Ct. 763 (1957), the issue was the propriety of Alleghany's having issued a new class of preferred stock. The Commission approved this. The three judge district court set aside that order of the Commission Alleghany had applied to the Commission for status as a non-carrier to be considered a carrier and asserted that the Cleveland, Cincinnati Chicago & St. Louis Railroads, the big four, the Louisville and Jefferson Bridge & Railroad, the New York Central, and Alleghany applied for merger authorization. Big four already owned the stock of Jeffersonville. The Central owned 98.98% of the common stock of the big four and 86.45% of the preferred stock of it. The Commission approved the merger of the Jeffersonville into the big four. Alleghany then applied to acquire the Boston and Albany Railroad, the Pittsburgh and North Adams Railroad, and the Ware River Railroad. Central owned more than 16% of Pittsville and operated the properties of the Boston and Albany, the Pittsville and the Ware under leases. This petition was approved. Alleghany then sought permission to issue convertible preferred stock, and this permission was granted by the Commission. Minority stockholders sued Alleghany to require the Commission to set aside its order granting Alleghany the status of a non-carrier considered as a carrier. The Commission in Alleghany argued in the Supreme Court that Commission approval was not necessary when there is an acquisition of a single, integrated system. The Court quoted the Commission as having pointed out that Alleghany had succeeded in electing sufficient members of the board to elect their own officers and that the directors' tenure depends upon their compliance with the shareholders who elected them. This constituted Alleghany's control of Central. In referring to an earlier decision, the Court held that a non-carrier parent of a carrier in proposing to purchase a property and franchise of another carrier acquired control in such way as to be subject to this Commission's jurisdiction. The Court held that a parent company having control of a carrier may not procure other carriers through the carrier without compliance with the jurisdiction of the Commission. 77 S.Ct. at 773. "In other words, a non-carrier may not gain internal 'control' over carriers free of Commission regulation merely by operating through subsidiaries." Ibid. The evil to be avoided was pointed out by the Court: the practical effects may be minimal at first, but so long as Jeffersonville existed as a separate company, it was always a possibility that the big four might sell or be forced to divest itself of Jeffersonville, with control passing to another carrier. This was significant in view of the fact that Jeffersonville did not connect physically with big four but only through big four's trackage rights over the B&O. That small company also connected with the Pennsylvania, the B&O, L&N, IC, and C&O. The merger of Jeffersonville into the big four virtually precluded any change in the relationship of Jeffersonville to the central system. Thus, there could not be said to be no increase in power of the big four, the central, and through its relationship, Alleghany, over the Jeffersonville. The Supreme Court said:

> Denial of power to the Commission to regulate the elimination of the Jeffersonville from the national transportation scene would be a disregard of the responsibility placed on it by Congress to oversee combinations and consolidations of carriers * * *. 77 S.Ct. at 169.

The matter was remanded to the district court which more succinctly described the issue as Alleghany controlling the Central, the Central controlling a large number of other carriers. The Commission had not been asked to approve Alleghany's acquisition over this group of carriers. The question was whether Alleghany's acquisition of Central as a system must be validated by the Commission. The district court pointed out that it had been the consistent view of the Commission that its approval of acquisition of control and a finding of public interest were necessary. When this once was reversed by the Commission, the district court before the Supreme Court opinion reversed that holding. The Supreme Court left the question open, and the district court then said:

> Without going into the question of whether our previous determination in this regard remains the law of the case we express our conclusion that such approval is required. The statute unequivocally requires Commission approval for the acquisition of two or more carriers by any persons. * * * Its language does not suggest any exceptions and certainly none on the basis of common control by someone else having been previously authorized. It seems tous that as long as the carriers remain unmerged and unconsolidated, the Commssion has full power and the duty to decide whether control of them all or any of them by the proposed new person is in the public interest. This was the unchallenged prior consistent administrative interpretation by the Commission 232 F.Supp. at 232.

While that judgment was reversed by the Supreme Court, it was done so only because the issue had not been left open by the Supreme Court's earlier memorandum. No discussion of the legal issue was involved. *Alleghany Corp. v. Breswick & Co.*, 355 U.S. 415, 78 S.Ct. 421 (1958). There apparently was no dissipation of jurisdiction, for later on the district court held that the Alleghany's issuance of stock as approved by the Commission was consistent with the Interstate Commerce Act. *Breswick & Co. v. United States*, USDC New York, 160 F.Supp. 754 (1958).

The matter is clarified by *United Parcel Service Inc. v. United States*, 7th Cir., 612 F.2d 277 (1979). There, the holding company owned all of the stock ofone common carrier operating in the mid-Atlantic states and all of the stock of another carrier operating throughout the rest of the United States. The holding company and the two held companies then requested the Commission for authority to merge the two held companies. The Commission approved and held that the holding company would thereby acquire control of the surviving corporation and become a carrier within the meaning of the Act. The UPS case was distinguished from *Alleghany* as one wherein the UPS the subsidiaries t elescoped horizontally whereas in Alleghany they telescoped vertically. On the basis that the transaction improved the UPS capacity to make changes with greater legal ease, the holding company was held to have an acquisition of control within the meaning of the Act. The Court said:

> Congress has also given us some views of its intention in regard to carrier mergers. In 49 U.S.C. Section 11343(a)(1) Congress required Commission approval and authorization of the merger of two carriers into one corporation and those cases where no holding company non-carrier is involved. 612 F.2d at 281.

The Court concluded that the holding company would be subject to the Act.

There is no particular necessity for the Commission's deference to bald statements by carriers that they operate a single, integrated system. Even such a system should be additional reason why a holding company would be subordinated to the Interstate Commerce Act by reason of the fact that diversion of assets from a holding company operating a single, integrated system could jeopardize even a larger railroad transportation system. The courts have deferred to the ICC on the concept of the single, integrated system. The ICC, at least as demonstrated by the Burlington Northern holding company formation, defers to the unsupported record in agreeing with the carrier's statement of the nature of its system. The statutes do not necessitate such judicial or Commission deference.

EMPLOYEES LITIGATION WITH BURLINGTON NORTHERN SINCE THE MERGER IN 1970.

The Supreme Court of the United States on February 2, 1970 approved the merger of the various carriers into the Burlington Northern Inc. The Court ordered enforced the merger order issued by the ICC. United States v. Interstate Commerce Commission, 396 U.S. 491, 90 S.Ct. 708 (1970). The merger became effective on March 3, 1970, and the Commission enforced the employee protection as required by the Interstate Commerce Act, then Section 5(2)(c). That section provided that the merger must be subject to an approval of the ICC and that the Commission "shall require a fair and equitable arrangement to protect the interests of the railroad employees affected." The Commission pointed out in its merger order, Great Northern Pacific and Burlington Lines, Inc. - Merger Etc.- Great Northern Railway Company, et al, December 15, 1967, 331 ICC 228 (1967). This reversed the earlier Commission decision which had denied the applications for merger. 328 ICC 460 (1966). That earlier order found that 5,200 jobs would be lost on the various carriers. The cost of employee protection had been estimated at $4.96 million. The new report considered subsequent agreements between the carriers and the Brotherhood of Locomotive Engineers and the Brotherhood of Railway Trainmen and estimated the cost at $10.15 million, but the Commission pointed out that in addition to the greater cost for employees, the protections were improved. The new agreements were to assure employment and earnings, expedite changes in services, prescribe procedures for modifying existing agreements, and employ all covered employees of the various carriers so that "no employee is to be deprived of his employment status or placed in a worse condition with respect to compensation, rules governing working conditions, fringe benefits or rights and privileges pertaining thereto at anytime during such employment." 331 ICC at 277-278.

My own personal experience since that time has demonstrated a great vacuum in what is allegedly provided and what has not been provided.

Eight days after the Supreme Court decision, we were involved with the United Transportation Union in a lawsuit which gave rise to the Northern Pacific attempting to deal with the Brotherhood of Locomotive Engineers and the UTU over locomotive engineer apprentice training programs. The Court held in this matter, which arose actually before the Supreme Court order approving the ICC merger, that the carrier must deal with each of the two unions separately. Northern Pacific Railway Co. v. Brotherhood of Locomotive Engineers and United Transportation Union, DC Minn., 308 F.Supp. 995 (1970).

Within days after the merger had become effective on March 3, 1970, the affected carriers announced a radical and extreme change of working conditions and interchanges in the Duluth, Minnesota, Superior, Wisconsin area. The UTU then obtained a preliminary injunction barring a change in operations whereby the carriers had attempted to change the method of interchange at the Fifth Avenue interchange at Duluth between the Duluth, Winnipeg and Pacific Railway and the Chicago and Northwestern Railway over tracks of the B.N. The Court ordered the carriers to return to the earlier method of operation which had been a practice for many years up to the announced date of the change, March 13, 1970. After the Court order of October 8, 1970, the court modified the order on November 4, 1970. The Court determined the facts in the situation and found that the interchange could not be effected without ICC approval by reason of Section 49 U.S.C. Section 1(18) and Section 5(2)(a)II. It held

Section 6 of the Railway Labor Act, 45 USC 156 enables the Court to issue a temporary injunction to maintain status quo pending the conduction of mediation proceedings. The net result of the proposed changes would have been the elimination of employment for about 30 union members, some of whom had been employed for 30 years by the interchange carrier Lake Superior Terminal and Transfer Railway Company, a subsidiary of the Burlington Northern, the Chicago and North Western Railway Company, and the Soo Line. The DWP since 1912 had operated under a written agreement with limited trackage rights over the B.N. tracks from 44th Avenue West to 16th Avenue West in Duluth with an interchange connection with the C&NW at the 5th Street yard in Duluth. That 1912 agreement limited the trackage use to passenger, lake bound, or local freight but required that all through cars, not terminating in the Duluth Superior area, go over the Grassy Point route to the LST&T yard for interchange by those employees with the C&NW and the DWP.

The crux of the litigation was condition 30 of the ICC merger order, which required that the B.N. shall grant trackage rights to the DWP on agreeable terms to handle the through traffic. The carriers contended that condition 30 used the word shall and therefore meant that such condition must be granted irrespective of ICC approval or further consideration. The Court, however, granted the preliminary injunction and cited the provisions requiring equitable arrangements for the employees affected. The Court stated "the plaintiffs represent a group of men who have suffered and are suffering an economic loss and thus in the Court's opinion have standing to bring this lawsuit. As a result of actions of carriers by whom they are not employed and over whom they of course have no control, they are suddenly unemployed."

The Court deferred to the ICC for a determination as to whether this was an extension or an abandonment within the meaning of the Interstate Commerce Act or in any other way required a certificate from the Commission, whether the amendment of the 1912 DWP - NP agreement required approval from the ICC, and whether the economic loss to the employees must be considered by the ICC, and whether there are other questions that should be heard by the ICC subject to judicial review. United Transportation U. v. Burlington Northern, Inc., DC Minn., 319 F.Supp. 451 (1970).

We engaged in extensive correspondence between the Burlington Northern and the ICC in respect to obtaining protection as required by 52f of the Interstate Commerce Act for the 30 employees of the LST&T. We then filed a petition with the ICC for imposition of protection.

Contemporaneous with the problems in Duluth were the rearrangement of working facilities in the St. Paul Union Depot Yard. This must be considered directly related to the B.N. merger. We contended that the abolition of the job assignments was barred by the Railway Labor Act in the absence of mutual and common agreement with the union, but the courts held that there had been a standing practice to enable the carrier to make unilateral abolition. UTU v. St. Paul Union Depot Co., 8th Cir., 434 F.2d 220 (1970). There then was injunctive action taken to bar the B.N. from implementing changes and agreements between the UTU, the B.N., and the BLE with respect to the UTU seniority list controlling the movement of personnel between engineer and firemen crafts. That complaint was denied. UTU v. Burlington Northern, Inc., DC Minn. 332 F.Supp. 486 (1971).

The ICC finally made a ruling, almost two years after the merger, on our petition to impose protection for the 30 employees of the LST&T. Great Northern Pacific and Burlington Lines, Inc. - Merger, Etc. - Great Northern Railway Company, et al. 338 ICC 782

(1972). The ICC pointed out that the B.N. owned two thirds of the LST&T, while the Soo Line owned one sixth, and the Northwestern owned one-sixth. It quoted the B.N. contention that:

> The LST&T is a separate corporate entity, carrying on its own business as a terminal switching carrier. It employs its own personnel, purchases, owns, and maintains its own equipment, and in all respects is divorced from the parties participating in the Northern Lines Merger case.

While the B.N. seems to contend there that the LST&T is totally separate, in subsequent litigation with our unions, the B.N. has contended that whatever carriers it controls is part of an integrated railroad system to avoid imposition of designation of carrier over the newly formed Burlington Northern holding company. At any rate, the following is illustrative of the contentions of the carriers at the expense of the employees.

> In their verified statements both Burlington and Northwestern strongly objected to the imposition upon them of any financial liability should the Commission find that the LST&T employees are entitled to protection. Burlington argued that since the fulfillment of the condition will result in benefit to Northwestern principally at its expense, Northwestern should absorb the burdens of employee protection incident to that benefit. On the other hand, Northwestern inferred that it had been lulled into believing Burlington would incur the financial burdens of traffic protection incident to the merger. Northwestern felt that any additional burden imposed upon it would violate the condition of the Commission's conditions generally and condition 30 in particular.
>
> Subsequently, however, counsel for Winnipeg notified the Commission that Burlington and Northwestern had agreed to share the costs of employee protection equally. This agreement is contingent upon a finding for complainant in the instant proceeding in the imposition of the protective conditions referred to in Oklahoma R. Co. Trustees Abandonment, 257 ICC 177 (1944).

It very clearly appears that everybody assumed that everyone else would pay for the losses to be sustained by the employees.

With halting rhetoric, the Commission finally got around, two years after imposition of losses to the employees, the ICC held that the amendment to the 1912 trackage rights agreement required ICC approval.

Within two months, we were back in court in an attempt to enjoin firemen assignments on locomotives so that they in Wisconsin, which had a full crew law, would have turn around assignments for firemen. It was held that the test to be applied was that if the contract be reasonably susceptible to interpretation sought by both the carrier and the union, the dispute was minor and was outside of the judicial jurisdiction and had to go to the National Railroad Adjustment Board. The change, therefore, could not be enjoined in the absence of proof of irreparable harm.

UTU v. Burlington Northern Inc., 8th Cir., 458 F.2d 354 (1972). One month later, we were in court to enjoin a change in the method of overtime rate of pay when switchmen were called to work on a successive shift or trick if it be with a different crew. The carrier, however, argued that there were problems with the Hours of Service Act amendments. The Court was of a mind that this was a minor dispute and not subject to injunction. UTU v. Burlington Northern Inc., DC Minn. 344 F.Supp. 659 (1972).

The Court of Appeals in late 1972 affirmed the lower court decision denying the motion for preliminary injunction on the basis of the pre-merger agreements with the various unions. The Court affirmed the denial of the motion but did order that the matter should be submitted to the NRAB. UTU v. Burlington Northern Inc., 8th Cir., 470 F.2d 813 (1972). The NRAB later on held that there was no jurisdiction.

The carrier then used the merger authority, it thought, to transfer firemen from the Duluth Superior terminal to work as hostlers in the St. Paul - Minneapolis area. The complication was that the Wisconsin Full Crew Law had been amended, after the B.N. merger. The firemen involved were hired between the date of the B.N. merger and the repeal of the Full Crew Law. The repeal of the Wisconsin statute, however, provided that no employee would be transferred without his approval. The Court held that the matter for interpretation was exclusively within the jurisdiction of the adjustment boards but that there could be no transfer until such time as that board had been convened by reason of the fact that the transfer of the employees without additional compensation would sustain irreparable injury. UTU v. B.N., Inc., DC Minn. 382 F.Supp. 896 (1974). The public law board which was convened pursuant to that court order sustained the position of the UTU on March 10, 1975; and the result, of course, was that the carrier could not unilaterally transfer these people. The actual result was that the employees were in a bargaining position to arrive at adequate financial compensation for agreeing to transfers.

We were also involved in subordinate, attenuated issues, such as Riddle v.Burlington Northern Inc., 474 Civil 556, 1975, where our investigator had been discharged from the Burlington Northern because he was investigating on behalf of a client of ours, a fellow employee. He had been discharged because of the manifestation of disloyalty by reason of his investigating on his own property. The Court ruled that under the Federal Employers' Liability Act, the man was entitled to participate in investigations, and that 45 U.S.C. Section 60 forbade any contract, rule, regulation, or device which would prevent the employees from furnishing voluntary information about injuries.

In Jungmann v. Burlington Northern Inc., DC Minn. 79 L.C. 11, 605 (1976), the employees were entitled to guarantees under the merger protection agreement of the B.N. Amtrak was then created in 1970 and took over the B.N. passenger trains. In 1973, the B.N. agreed with Amtrak to employ the personnel on Amtrak over B.N. trackage. Amtrak then decided in 1973 to employ its own personnel directly. The B.N. and the union then agreed on an implementing agreement to continue the merger protection agreement of the B.N. to the employees going over to Amtrak with the provision that they could accept employment with Amtrak and maintain the merger protection of guarantees if they be laid off or they could decline Amtrak employment and retain the B.N. protection. The plaintiffs involved in the lawsuit agreed to work for Amtrak. The B.N. then notified them that they were no longer employees of the B.N. Claims were filed for protection under the B.N. merger agreement. The arbitration committee considered the matter and found that the employees had been employed with Amtrak and had left the B.N. and therefore lost any rights under the merger protection agreement. The Court refused to upset the arbitration agreement because of the deference which arbitration receives from the judiciary. The employees, of course, lost.

Several employees filed complaint with the ICC in 1975 against both the B.N. and various unions, including the UTU and charged that all the respondents had failed to abide by the labor protections imposed. The Commission held that the jurisdiction would extend only to the matters relating to affected employee compensation guarantees or matters intimately related thereto or to matters in violation of a specific condition. The employees there were held not to have complained of violations of the protective conditions and therefore had no complaint remediable by the Commission. Kenneth William Leavens, et al v. Burlington Northern, Inc., 348 ICC 962 (1977).

A judicial saga began in 1974 when there was a quarrel between the UTU, the BLE, and the B.N. By way of background, the Railway Labor Act authorizes railroad employees to belong to unions other than the craft collective bargaining representative. Because of the relationship between the locomotive engineers and firemen, with the engineers sometime working as firemen, and the firemen being promoted to engineer, depending upon the ebb and flow of the work load, many employees belong to both unions. Each union, however, entered into a separate merger protection agreement with the B.N. in accordance with the Interstate Commerce Act, Section 52F. The workload for engineers in Canada was reduced by reason of the Canadian law on wages and hours. The B.N. accordingly reduced the wage guarantees provided to the engineers affected. However, the engineers disputed this transition factor and asked the UTU to process the grievance. That union did so, but it was unable to resolve the issue with the carrier. It then, in accordance with the Railway Labor Act, sought to convene a UTU-B.N. special board of adjustment. The B.N. objected and itself submitted the matter to the merger protection arbitration panel established by reason of the BLE-B.N. merger protection agreement. Our argument was that although the claims arose under the BLE-B.N. merger protection agreement, the UTU could represent the claimants in a public law board wherein the UTU would be a panel member of the arbitration board instead of the BLE. The District Court ruled against the employees seeking to select their own claim representative, the UTU. The District Court denied our complaint. The Court of

Appeals in 1977 ruled that notwithstanding that the Interstate Commerce Act provided for the establishment of merger protection agreements and arbitrations panels to interpret those agreements, the Railway Labor Act authorized the selection of one's claim representative to establish a public law board. The Court held that the UTU could establish a public law board to interpret a BLE agreement. The Court, however, considered the additional problem, that there was involved here the applicability of the Canadian legislation and remanded for further consideration in regard to that. General Committee of Adjustment v. Burlington Northern Inc., 8th Cir., 563 F.2d 1279 (1977).

While that case was remanded to the District Court and by the District Court to a U.S. Magistrate, several employees sued the B.N. to set aside an arbitration award which we alleged had deprived them of certain seniority rights in violation of the Interstate Commerce Act. Those 13 employees contended that the arbitration awards deprived them of the merger protection which was granted by reason of the merger and cited Norfolk and Western Railway Company v. Nemitz, 404 U.S. 37 (1971). The Court, however, refused to upset the arbitration award because the implementing agreement had not actually been approved by the ICC but was rather agreed to after the merger had occurred. It was our contention that the merger protection agreement was necessarily entered into by reason of the provisions of the B.N. merger order of the ICC. B[illegible]o v. Burlington Northern Inc., 479, 274 (1974).

The Court of Appeals considered the UTU's claim on arbitrating the BLE dispute in General Committee of Adjustment v. Burlington Northern Inc., 8th Cir., 620 F.2d 161 (1980). In this second decision on that issue, the Court held that the Canadian tribunals must determine whether under Canadian law the UTU has a right to sit on a panel to consider merger related disputes involving members in Canada on issues affected by Canadian law. This holding was despite the concession all through by the B.N. that if the UTU could establish a public law board on the BLE issue, there would be no other contest. Once we establish that right, the BN switched its position and contended that there was no jurisdiction to determine the Canadian claim.

The merger protection agreement was involved in Clausen v. Burlington Northern Inc., CV 76-89, USDC, Mont., 1980. I contended there that the plaintiff engineer fireman was working under the terms and conditions of the collective bargaining agreement with the UTU. While working as an engineer, he was, of course, bound by the terms and conditions of the agreement with the BLE. On January 25, 1975, Clausen was transferred from Seattle to Livingston, Montana, pursuant to terms memorialized in the letter of February 10, 1975, and whereby he relinquished his seniority in Seattle and established seniority at Livingston and also for $15,000. However, on May 23, 1975, the B.N. and the UTU entered into a collective bargaining agreement for transfer benefits in the amount of $22,000, which exceeded Clausen's individual contract by a sum of $7,000. Our contention was that the Interstate Commerce Act provided the necessity for the equitable arrangement by reason of 52F and that the merger protection agreement provided, necessarily, that there would be a future contract for transfers. The contention was that the individual agreement conflicted with the Railway Labor Act and the Interstate Commerce Act and also the merger protection agreement. The evidence disclosed that other persons entered into other individual contracts for compensation varying from no money at all to $20,000. These individual contracts seemed to conflict with the basic collective bargaining principle that the union is the sole representative of the craft and the employees in that craft. While the Court acknowledged that there were no precedents with identical issues, the Court held that it was an issue for interpretation and therefore not subject to the National Railway Adjustment Board. Although that matter was never appealed, a companion case which I initiated in Wyoming is pending in the 10th Circuit.

Will Rogers reported the following:

> Say, did you read what the President said about those 'holding companies'? Wouldn't want my worst enemy to call me names like that. Now senators can call each other names, but theirs is all in good clean fun. They don't mean it, but the President ain't kidding.
>
> And what makes it worse, it's true: A holding company is a thing where you hand an accomplice the goods while the policeman searches you.

After the Burlington Northern had announced its intention to form a holding company after the shareholders meeting of May 14, 1981, the unions requested that I seek appropriate relief. I filed a petition with the ICC for an investigation into the matter. That was filed on April 30, 1981. I also filed a complaint for a temporary restraining order and preliminary and permanent injunction on the basis that the ICC Frisco Merger Order foreclosed the formation of a holding company, that it involved more than one carrier and that therefore the holding company would be considered a railroad, and that the holding company could not be formed without an ICC order approving the holding company structure. The trial court turned down our motion for a preliminary injunction. Brotherhood of Railway and Airline Clerks, et al v. Burlington Northern Inc., DC Minn., 513 F.Supp.

1023 (1981). That order denying the motion for preliminary injunction was appealed to the Court of Appeals, which dismissed for lack of jurisdiction. The ICC on June 5, 1981 entered an order refusing to investigate the BN holding company. That matter was submitted to the Court of Appeals by appropriate petition, *Brotherhood of Railway and Airline Clerks v. B.N. Inc. and USA*, 8th Cir., 81-1661 (1982). On February 17, 1982, the Court of Appeals held that the comments in the Frisco Merger Order in respect to the holding company did not impose conditions barring the formation of the holding company. The Court deferred to the ICC's interpretation of its own order. The Court held further that the State of Minnesota, a bondholder, had not sought judicial review of the ICC merger. Minnesota's contention, based upon our petition, was that certain mortgages issued in 1896 foreclosed the formation of a holding company. Because no bondholder petitioned the Court for a review of the ICC order denying our petition for investigation, the Court held that there was no issue before the Court on the matter because the unions, not holding any bonds, had no right to contest the issue. On the third issue, however, as to whether the Interstate Commerce Act foreclosed review of the holding company structure, it was pointed out that under 49 USC Section 11343(a), certain holding companies could be considered carriers. The B.N., of course, contends that its subsidiaries operate as a single, integrated transportation system. The ICC has held for 25 years that a single established carrier system, even if composed of separate corporate entities, is not subject to Commission jurisdiction. While as we will point out there is no necessary conclusion to that effect from the Interstate Commerce Act, the issue would of course be whether there is a single integrated system. With respect to certain switching and terminal companies, the B.N. does concede that they are not part of the B.N. system and are not to be considered carriers for the purpose of imposing control over the holding company because the B.N. does not control those switching and terminal companies. Their interest varies from 7.7 percent in the Belt Railway of Chicago to 40 percent in the St. Paul Union Depot. The Court of Appeals directed the ICC to determine whether there are in fact companies under the control of the B.N., ourside of the single, integrated system of the B.N., and what are the factual bases for the Commission's order. That matter is now before the ICC.

THE COMMISSION'S INCONSISTENT STATEMENTS ABOUT JURISDICTION OVER HOLDING COMPANIES CANNOT VIOLATE THE CLEAR WORDING OF THE STATUTE GRANTING THE COMMISSION JURISDICTION OVER HOLDING COMPANIES.

The Commission seems to run with the hares and ride with the hounds on the subject of whether there has to be legislative changes to exert control over holding companies owning railroads to the same extent as it manifestly exerts control over railroads.

The Commission has broad power over a non-carrier acquiring control of a carrier. Section 11348 provides as follows:

> (a) When the Interstate Commerce Commission approves and authorizes a transaction under sections 11344 and 11345 of this title in which a persn not a carrier providing transportation subject to the jurisdiction of the Commission under chapter 105 of this title acquires control of at least one carrier subject to the jurisdiction of the Commission, the person is subject, as a carrier to the following provisions of this title that apply to the carrier being acquired by that person, to the extent specified by the Commission: section 10764, subchapter III of chapter 111, and sections 11301, 11302, 11709, 11711, 10901(f), (h)(1), 11909(a), (b), and 11911(a).

The statute specifically grants discretion to the Commission by the phrase "to the extent specified by the Commission." There can be no doubt but that Congress has empowered the Commission to control a company which has acquired control of at least one carrier subject to the jurisdiction of the Commission. The statute so provides, and the Commission should hold. The net result, of course, is that the Commission may rule that the Burlington Northern holding company is as subject to the Commission by owning the subsidiary railroad as it would be if it owned and operated the railroad directly as its own property.

Once the holding company is considered a carrier, either because of the discretionary extension by the Commission, as granted by the statute, or because the Burlington Northern holding company will own more than one railroad, then the Commission should direct the Burlington Northern holding company to comply with the principal statutes which are obligatory upon railroad carriers.

Congress should impose obligations that require Commission approval for the issuance of any securities by the B.N. holding company. See Section 11301(b)(1). Section 11348(b) provides that for the company acquiring control of a carrier, the Commission may authorize the issue of securities only if it finds that the issue:

> (1) Is consistent with the proper performance of public transportation by the carrier that is controlled by that person:
> (2) Will not impair the ability of the carrier to provide public transportation; and
> (3) Is consistent with the public interest in other respects.

These restrictions are the minimal constraints upon a railroad for the protection of the railroad transportation. They are certainly not onerous, especially when one considers the extravagant wealth that has been acquired by this railroad over the 116 years of its history and over its 102 mergers. Section 11301 empowers the Commission to have exclusive jurisdiction to approve issuance of securities by a carrier and the assumption of an obligation or liability.

The Supreme Court years ago established the underlying philosophy for the Commission. In Interstate Commerce Commission v. Chicago, Rock Island, and Pac. Ry. Co., 218 U.S. 88, 30 S.Ct. 651, 656 (1910), the Court said:

> The outlook of the Commission and its powers must be greater than the interest of the railroads or of that which may affect those interests. It must be as comprehensive as th einterests of the whole country.

> If the problems which are presented to it, therefore, are complex and difficult, the means of solving them are as great and adequate as can be provided.

The Court in that opinion admonished the Commission to exercise its powers "in the coldest neutrality." 30 S.Ct. at 656.

The Commission certainly has jurisdiction to control holding companies. The Interstate Commerce Act, 49 USC 11343(a). In Illinois Central Gulf Railroad Co. - Acquisition - Gulf, Mobile and Ohio Railroad Co., Illinois Central Railroad Co., 338 ICC 805 (1971), the Court discussed the discretion of the Commission. The Commission said:

> In real terms, the IU decision [an earlier case] stands for the proposition that the test of whether a noncarrier holding company will be subjected to the provisions of Section 5(3) is not a standard which will only look to a breakdown of the percentage of transportation vis-a-vis nontransportation revenues for the companies controlled by the holding company in question. A broadened test will examine whether the holding company is in control of carriers who, by the size and nature of their operations, have a substantial influence on national transportation.

The Commission

> * * * put Industries in control of a rail system that will be able to marshall over $1 billion in assets in providing rail transportation to the Mississippi Valley region. This new system will likewise be in a crucial position insofar as rail transportation is concerned in this important commercial region of the Nation. With such a position in mind, it is fair to say that the merged system will have a substantial impact and influence on the national transportation system. Accordingly, we find that Industries should be considered a carrier under the provisions of Section 5(3) of the act for the purpose of compliance with section 20a to the extent next discussed. 338 ICC at 856-857.

The Commission then referred to the former Section 5(3), which is now 49 U.S.C. 11348, the section which empowers the Commission to determine the extent of its control over a person which is not a carrier but acquires control over the carrier; and the Commission concluded that it would apply the provisions controlling securities only when the security issuances are related to the carriers under control of the holding company. There is no statutory limitation that requires this narrow construction. If this be the definitive ruling of the Commission, it certainly should be reversed. The limitation is not necessitated by statute, as the Commission knows.

In the hearings before the Committee on Interstate and Foreign Commerce, United States House of Representatives, as reported in Emergency Rail Services Legislation, Mr. Paolo, Director, Bureau of Accounts, Interstate Commerce Commission, under date of March 11, 1969, wrote a memorandum to the chairman of the Commission on rail conglomerates. He recommended as follows:

> Railway systems are made up of two or more carriers, some operating independently of each other. Therefore, it is strongly recommended that the Commission take another look at its position that in the acquisition of a railroad system a holding company is not construed to be a carrier under the terms of Section 5 of the Act.

Quoted in this same Committee report is a study of the Commission's Bureau of Economics, March, 1969, and entitled Conglomerate Merger Activity of Class I Railroads and Related Regulatory Problems. At page 1077 of the House Reports, the followingis argued:

> Holding companies of today, however, are formed to acquire enterprises in other industries. This raises the question of whether a holding company having only one regulated carrier as a subsidiary is presently subject to the Commission's authority in the issuance of securities.
>
> To date the Commission has declined to extend its section 20, 20(a) and 20(b) authority to conglomerate holding companies. It is strongly recommended that this position be reversed. It is obvious that rail companies could become involved in a precarious financial condition as the result of unsound security issues by the conglomerate parent. If this should occur, the primary source of income or assets would appear to be the

> carrier component of the holding company. The potential risks to the future of rail service seem great enough to warrant the extension of ICC control to the holding company.

The office of the general counsel wrote a memorandum of March 28, 1969, Conglomerate Mergers, and that was attached to the House Reports. At page 1130 of the House Reports, the Commission's General Counsel argues:

> The legislative history of Section 5(3) makes clear that the fact that the railroads are themselves subject to regulation affords no basis whatever for concluding that a non-carrier acquiring control of more of them should not be subjected to the requirements of Section 20a of the Act. Indeed, there would have been no occasion for the enactment of its provisions if that were the case, for the Commission had such regulatory jurisdiction over the railroads all along.

In its report to Congress on February 5, 1977, the Commission report, Railroad Conglomerates and Other Corporate Structures, stated:

> The Interstate Commerce Act gives the Commission the power to designate as a carrier--and thus to make subject to our reporting requirements, visitorial powers, and jurisdiction over securities issuances--over any person newly authorized to acquire control of a railroad. Thus, to the extent that acquisition by a non-carrier of control over a single railroad was to be made subject to the Commission's jurisdiction, the Commission would possess discretionary authority to inspect the books and records of the controlling entity, to require it to report on its railroad-related activities, and to require prior approval of its securities issuances. These powers are important ones if we are to assure that those in a position to control a railroad are exercising that control in a manner consistent with the public interest, and are not improperly diverting railroad assets to other corporate purposes. P. 73-74.

The Commission in its report to Congress made the further statement at page 75:

> A reading of the statute convinces us that an equally plausible and supportable interpretation would have been one which found that the acquisition of control over any two or more railroads, regardless of whether they were operated as a single system, was subject to

> the Commission's jurisdiction under Section 5(2), and that the Commission possesses the authority, under Section 5(4), to designate any person acquiring control over any two railroads as a rail carrier and is subject to the reporting, investigatory, and securities provisions of the Act.

It is obvious that the Commission understands the specific provisions of the statute and that it does have the power to assert jurisdiction over the holding company. When it fails to exercise its discretion as mandated by Section 11348(a), it merely decides that it has no jurisdiction. The Commission is patently not exercising discretion and is therefore acting in an arbitrary and capricious manner.

ICC NOTES ON HOLDING COMPANIES IN B.N.-FRISCO MERGER

A holding company corporate form is the ideal answer to financial manipulations. This is not to suggest that all holding companies are designed solely for manipulation, but rather that that form makes manipulations easier to accomplish and harder to detect.

The Frisco Merger Order, 360 ICC 788 (1980) considered many aspects of railroad corporate structure. It discussed the Illinois Central Gulf Railroad, whose net income declined from $45 million in 1973 to a loss of $2 million in 1978. From 1974 to 1978, ICG had insufficient working capital to meet monthly average working capital requirements. The Frisco Merger Order then said:

> Its parent company monitors the carrier's cash and financial requirements closely and the cash flows freely between parent and subsidiary on a daily basis. However, it seems reasonable to assume that there is a practical limit to how much assistance the parent would supply to the railroad, especially since the parent plans to eventually dispose of the railroad. 360 ICC at 1125.

The ICG and other railroads were considered in the emergency rail services legislation hearings before the Committee on Interstate and Foreign Commerce of the U.S. House of Representatives in 1970. While that is not a current report, I believe that it is important and relevant from the standpoint of considering corporate structures and operations. The ICC director of the bureau of accounts on March 11, 1969 sent a detailed special review of railroad conglomerates to the Commission, and this was made available to the House Committee. It pointed out that the Illinois Central holding company entered into an agreement with the IC railroad to pass all Industries dividends received from the railroad to the stockholders of Industries on a dollar for dollar basis. But Industries, the holding company, desired to increase its retained income balances but could not accumulate earnings from the railroad because of the dividend agreement. What then occurred was the Industries advanced $600,000 to the Chicago and Illinois Western Railroad Company, a wholly owned subsidiary, and that subsidiary paid the $800,000 dividend to Industries. This depleted the railroad's retained income and made money available for the holding company to retain. That was in 1967. The holding company on another occasion charged the Illinois Central Railroad more than its share of the federal tax liability and from 1963 to 1968, received $1.4 million more than its actual requirements. In 1966, the holding company paid no taxes but the railroad paid it $150,000 for federal income taxes. It was pointed out that the IC holding company was able to conduct its operations without paying any officers' salaries, for they were all supplied free by its railroad subsidiary.

The ICC did inform the House Committee that:

> It is not in the public interest for a carrier to pay out substantially all of its retained income in dividends, especially when such payments are made with borrowed funds.

That is exactly what the IC railroad did to the IC Industries holding company in 1967.

The Frisco Merger Order considered the Chicago and North Western, which of course has been sold to the employees. In only one year since 1973 did the C&NW report a net income: $3 million in 1976. 1973 was the last year that it had a positive working capital, and even then it was well below the monthly average working capital requirements. "C&NW's financial condition has been deteriorating progressively and the carrier is in marginal financial condition. * * * The carrier's cash position has been weakening and in February, 1979 a draw down on a line of credit helped it to avert a cash crisis. * * * C&NW has been successful in obtaining federal financing and federally guaranteed loans. Since September 9, 1979, FRA has approved C&NW applications totalling $192 million." 360 ICC at 1111. Its cross-tie replacement levels had been consistently below the ICC benchmark, and its track had 60 percent of it under slow order as of December 31, 1978.

The House Committee obtained information about the C&NW, although it was 10 years earlier. The House learned that the C&NW Railroad was the basis for the company jumping into the conglomerate area by the sale of railroad real estate. As far back as 1969, the C&NW had a plan to dispose of all its real estate holdings not currently used in carrier operations. Its 1967 report to its stockholders confirmed real estate sales of $7 million, of which $5.8 million was credited to income. During the last nine years up to 1967, the real estate sales totalled $65.5 million. It certainly sounds familiar to anyone following the current demise of the Milwaukee Road.

One of the benefits of a holding company is shown by the C&NW Railway receiving no compensation for its tax benefits used in its consolidated return. That is just like the IC. The Industries was originally incorporated in 1967 as a subsidiary of the railroad, it became the holding company on April 4, 1968. According to the 1969 report to the Congress, 40 percent of the revenues were obtained from transportation services. When the Industries became the parent of the railroad, it established a dividend policy whereby the holding company would pay cash dividends. If the holding company be unable to pay the dividends, it will call for increased dividends from some or all of the subsidiaries for the holding company to carry out its dividend policy. In 1963, the Philadelphis Reading Corp. paid Industries some $17 million, the amount equal to its federal income tax liability if it had filed on an individual basis. This increased income to the holding company of between $12 to $13 million. The Industries officials would not divulge any credits for loss carry forwards which on December 31, 1967, was $8.4 million.

The net result is that the railroad was lending money to its holding company at prime interest rates, which of course deprives the railroad of those funds. And at a very low interest rate. Loans from the railroad to the C&NW holding company were used to acquire 50 percent of Alton Southern, plus the Des Moines and Central Iowa Railroad, and the Fort Dodge Railroad Company, and some substantial improvements to plant. No particular benefit to the railroad is demonstrated by that. The low interest loans from the railroad to the C&NW holding company were $14 million, which deprived the railroad company of funds that it could use for its own purposes.

The report filed with the House Committee, that is the memorandum from the Bureau of Accounts to the chairman of the ICC, stated as one conclusion:

> The serious financial manipulation set forth in this memorandum, whereby assets and earnings of railroads are being dissipated to non-carrier companies in the group, are definite indications of what may be expected in the future--all of which are detrimental to the carriers and hence to the national transportation needs of the public and national defense.

That report recommended that the Commission take another look at its position that in the acquisition of a railroad system, a holding company is not construed to be a carrier. It seems that the non-political personnel of the ICC can recognize the dangers and damages done by the convuluted interpretation of the act, which clearly grants ICC jurisdiction over any holding company that owns two or more carriers.

The Frisco Merger Order authorized the merger and the issuance of securities by the carrier because the issuance would not impair the financial ability of the carrier to provide the service. 360 ICC at 959. This, of course, is the severe stricture which the B.N. wants to avoid so that it has no limitations on the purposes for which it issues securities, raises funds, and transfers assets. It was pointed out very clearly that the ICC apparently understood, unless the merger order was written by a devoted bureaucrat, just what is involved in a holding company. It said the following:

> In 1977 B.N. launched a new five year plan that contemplates capital expenditures of about $2 billion for expansion and improvements. About half of the total will be for coal-related projects.
>
> The ability of a railroad to satisfactorily provide transportation services and to adequately rehabilitate its plant and equipment can be affected by its corporate structure. Those in a position to control a railroad's actions can divert the carrier's income, property, and other assets for non-rail purposes. This opportunity exists to a significant degree when a parent holding company controls the railroad.
>
> B.N. will not be in a position to form a holding company for many years due to bond indenture restrictions. Therefore, the opportunity for a diversion of assets to other sources does not presently exist. Also, the current management of B.N. appears to be fully dedicated to railroad operations. 360 ICC at 992-993.

The October, 1981 edition of the Burlington Northern News, issued to its employees, answered the question whether the B.N. wanted to get out of the railroad business as "no way." It said that those of use who are concerned about its devotion to continued railroad service point to reduction in capital spending. The contributing editor states this rebuttal to us critics:

> They ignore the fact that the railroad requires less investment at this point. There is an equipment surplus in many of the major building projects, such as the Gillette-Orin line in the Alliance Shop, are completed. Maintenance work will continue; but as any homeowner can tell you, repairing a house is far less costly than building it.

The Frisco Merger pointed out that the freight car maintenance ratio declined from 1971 to 1974 and this "indicates that B.N. has a higher bad order ratio than both the western district average and the total Class I average for 1977." 360 ICC at 995. The Commission said further:

> B.N. reported 783 accidents for 1976, second only to Conrail. Derailments account for 580 of the accidents. Track defects were related to the 46 percent (269) of derailments, while 29 percent (1968) of derailments were related to equipment defects. B.N. incurred monetary damages of $19.4 million. 360 ICC at 995.

The B.N. had a locomotive bad order of 104 of 2,042 locomotives for the year ending June 30, 1974; and 212 bad orders of 2,476 locomotives for the year ending December 31, 1978.

The Commission did point out that the transportation gross ton miles per man hour of employment, an important factor in determining productivity, had risen steadily with a total increase from 1970 to 1976 of 21.9 percent. 360 ICC at 1016.

The Commission really went out of its way to twist logic. The protesting carriers pointed out that there could be a reduced maintenance expenditure. Now the ICC takes over with a brilliant theory:

> Nevertheless, the operation of the freight cars over a right of way contributes to the deterioriation of the roadbed and track structure, necessitating periodic expenditures to restore these basic items to a usable condition. A permanent loss of the diverted cars, including related empty car movements, contributes to a deceleration of the deterioration, thus, saving funds otherwise required for roadway maintenance. 360 ICC at 1107.

That is a bit like saying that if your leg is cut off, the loss of the weight makes it easier to get around.

Just so that there is no question but that the ICC understood that there would be no holding company and that the assets would be available for the railroad transportation company, let me quote to you what the ICC said in summarizing the contentions of the railroads, the B.N. and the Frisco, for the merger.

> Applicants contend that the merged rail company would be enhanced by B.N.'s non-transportation operations. These operations include the sale of timber and logs, the manufacture and sales of forest products, and the exploration, development and/or sale of petroleum, coal, and other natural resources. In addition, B.N. is engaged in air freight forwarding, as well as fixed base aircraft operations and real estate development. Applicants state that such non-transportation operations (particularly those involving timber and coal) permit B.N. to commit internally generated funds to capital intensive projects required by its rail service.

Just how long those internally generated funds will be applied to capital intensive projects for the railroad is hard to say. I think that if the B.N. obtains passage in Congress of a current proposal, the end is near. The proposal now before Congress is to eliminate the federal prohibition against railroads holding federal coal leases. The B.N. owns enough coal. Furthermore, the coal slurry comes back to mind by reason of the October, 1981 Burlington Northern News, where it is announced that the B.N.'s land and real estate subsidiary, the Glacier Park Company, is studying the feasibility of developing a multi purpose terminal facility in the State of Washington. It is just a small study, which will cost only about $1 million. Who is going to study it with Glacier Park Company? Arco Coal Company. That sounds an awful lot like Atlantic Richfield Petroleum.

THE DISTORTIONS PRESENTED BY THE B.N. DEMONSTRATE THE EVILS OF THE B.N. HOLDING COMPANY AS PRESENTLY CONSTITUTED.

The undersigned counsel and various representatives of the General Chairmen's Association on the Burlington Northern met with two vice presidents of the B.N. on Monday, April 27, 1981 in a conference attempting to resolve the complexities involved herein. Management pointed out that the Burlington Northern is the largest non-governmental owner of coal in the United States and is barred from carrying on its railroad line its own coal. In discussing what would result from formation of a holding company, and solely by way of illustration and with no commitment that this would be done, management pointed out that its wholly owned subsidiary, BNAFI, Burlington Northern Air Freight Inc., could be declared a dividend and transferred to the holding company tax free. BNAFI's current market value is estimated by management to be 150 million dollars. The vice general chairman of the BRAC inquired about the proxy statement to the effect that the holding company would not assume the liabilities of the railroad. Management said that the holding company cannot assume the railroad debts without its assets. Our quarrel, of course, is that it is assuming the assets without the debts. Management indicated that it would form a coal company under the holding company and lease the coal from the railroad. Other prime candidates for transfer to the holding company for forming into held companies or subsidiaries would be the trucking, timber, and some portion of the real estate. Oil and gas would be treated in a way analogous to the coal situation for the leasing of the natural elements from the railroad.

The striking conflict with what is represented is shocking.

The B.N. annual report for 1980 indicates that the railroad assets on December 31, 1980 were $4,550,233,000. All non-railroad assets are therefore evaluated at $716,772,000. Air Freight forwarder was listed at $59,820,000. Coal and minerals at $3,706,000.

Management informed counsel at the meeting on April 27, 1981 that the air freight forwarder was worth approximately $150 million. The $91 million disparity illustrates one of the problems that the annual report presents to the Commission. This is complicated by the example management gave for the transactions involving the holding company. As example, and we acknowledge that it was only as an example, which we believe may be prophetic, the BNAFI, worth $150 million, could be paid as a dividend from the railroad corporation to the holding company tax free. We believe that this is in violation of the Prior Lien Mortgage and the General Lien Mortgage; but we also believe that this is a distortion of the financial condition of the B.N. and warrants immediate action by the Commission to preserve the assets with the liabilities of the railroad.

A greater distortion, perhaps of monumental proportions, is the B.N. annual report evaluation of coal and minerals at $3,706,000. P. 33. The annual report, page 20, reports that the B.N. owns approximately 14.7 billion tons of economically mineable coal in Montana, North Dakota, Washington, Illinois, Missouri, and Alberta. Forty-five percent is sub-bituminous coal, mostly under lease. Fifty-five percent is lignite, of which 21 percent is under lease. Without rearranging what is under lease and what is not under lease, we can state without any quarrel that some of the leases are expiring in the 1980s and are therefore subject to renegotiation as to any royalties. Nowhere is there any explanation of how 14.7 billions tons of coal in the ground is worth the nominal figure of $3,706,000. There are ways to compute the actual value today.

The Burlington Northern received, 14 days after the Frisco merger had been accomplished on November 21, 1980, a research note from Morgan Stanley of New York, It is entitled Resource Rails A Comparison of Resource Asset Values. That is done on the Burlington Northern, Santa Fe Industries, and the Union Pacific. On page 1 it recites: According to a popular saying: "all wealth emanates from the land." Morgan Stanley pointed out that investors in an inflationary environment are interested in asset values, especially minerals and other ground resources. Many of these assets are not reflected in the books of rail companies, Morgan Stanley said, "because they were acquired through land grants or were purchased decades ago with very low costs." The new estimates were considered conservative by Morgan Stanley. Certain of the railroads are considered "resource rails," and the document then evaluated the three railroads. The B.N., it reported, had through its domestic natural resources contributed significantly in the preceding five years an approximatel 15 to 16 percent per annum in the B.N.'s income growth. The resources are not reflected on the company's books, because they came from the land grants.

While the B.N. 1980 report estimates oil and gas at $70,100,000 asset, Morgan Stanley estimates it at $212,000,000.

While coal and minerals are listed in the 1980 annual report at $3,706,000, Morgan Stanley appraised coal at $1,404,000,00. That is onthe basis of 6.7 billion tons of sub-bituminous coal at 12 cents per ton; and 8 billion tons of lignite at 7 1/2 cents per ton. Now, we must remember that this coal is under lease. In the April 27, 1981 edition of Forbes, an article by Paul Gibson about the Burlington Northern is entitled A Railroad for the Long Haul. At page 126, the author writes as follows:

> Similarly in coal. BN is no longer content just to collect royalties. 'We want to participate in the development of our resources,' insists Bressler, his brown eyes sparkling. Consider an agreement with Montana Power, which takes about 7 million tons annually off BN's property. The 16 cents a ton it pays was agreed to nearly 20 years ago. Now, says Bressler, royalty on a coal deal typically amounts to 12 1/2% of the selling price, often $1 a ton. He wants to renegotiate at a time when there is a surfeit of western coal, and power plants are talking about taking less not more--hardly a propitious moment. But Bressler's eyes gleam again. This is a case of you can pay me now or you can pay me later. 'They might find us a lot tougher to deal with in 1989 when that lease expires,' he says bluntly.

This demonstrates that the actual value, only for royalty purposes, of the coal is closer to $1 a ton. That would, of course, amount to a single asset worth 14.7 billion dollars although it is now valued at 3.7 million. Now, if we go one step further and follow Mr. Bressler's estimate of the royalty value, at 12 1/2% , the selling price of the coal would be approximately $8 a ton. That is the value to Burlington Northern, less whatever it takes to mine the coal. In addition, of course, Burlington Northern is the sole coal transport by rail that is available to the heavy coal mining of its own coal in eastern Montana. We believe that the astronomical values are not being demonstrated either to the Commission or to the shareholders. Furthermore, when management explained to us on April 27, 1981 that it could form a subsidiary of the Burlington Northern holding company and lease the coal to mine it and ship it by Burlington Northern Railroad, we can see without any problem that there is enormous potential for an economic dismemberment of the railroad as we know it today.

We are concerned with the rapid increase in the value of Burlington Northern shares of stock. When Morgan Stanley issued its report in December, 1981, it indicated that Burlington Northern's stock was at 72. That, of course, includes all assets. Morgan

Stanley, however, appraised the net present value of the natural resources at $103 per share; and that is of course totally without the railroad and its incidental appurtenances. The railroad is no longer the major asset in the corporation, except by annual segment information reports in the annual reports. The railroad has spawned an enormous conglomerate, and the formation of the holding company will unquestionably be the coup de gras of the railroad company, which will have no major assets that are easily convertible into good securities for new financing. What the holding company will do is increase the value of its shares, which has almost doubled since the present chief executive officer took over and, as is common with so many other railroad holding companies, split off the railroad as an unwanted orphan.

The interesting relationships in the Morgan Stanley report should be pointed out, although we cannot make a definitive comparisc Burlington Northern 14.7 billion tons of coal were estimated at 1.4 billion dollars. Santa Fe's coal was 768 million tons with 1.86 billion dollars. Thus, while B.N.'s coal is worth 10 cents a dollar, Santa Fe's is worth approximately $2.42 per ton and subject to long term utility contracts. The Union Pacific had 10.5 billion tons of sub-bituminous coal and evaluated at 20 cents per ton. It manifestly appears that the B.N.'s major assets are being stripped from the railroad without any plan to inform the Commission.

What have we to fear? The railroad will certainly contend that this holding company structure will strengthen the corporation, enhance its investment possibilities, attract new money, and be a better buy for the shareholders. We are concerned about the railroad.

The proxy statement pointed out the Burlington Northern's desire to avoid the Interstate Commerce Act because of the restrictions that all security issuances must be reasonably necessary for or consistent with the performance of a railroad. That is the Commission's role, to enforce this obligation. The proxy statement points out that the holding company would have greater flexibility to finance non-transportation business activities, expand acquisition of new businesses, and develop natural resources "owned by it or its subsidiaries." There has been for many years an industrial argument that there is a synergistic effect from the agglomeration of big businesses. It has never been found true in the railroad industry, and the deficiencies of major industries in this country must provoke the Commission at this time to be especially concerned about its prime obligation, the protection of the American railroads and the promotion of the national transportation policy.

The evils incident to the holding company operation start with available information.

> The information gap created by the suppression of conglomerates of industry data is, indeed, one of the most serious barriers to the regulatory mechanism. It impairs the functioning of the regulatory agencies and also prevents the natural forces of competition in the non-regulated industries from channelling limited resources to their most efficient uses in the public interest.

HOUGHTON, The Interstate Commerce Commission views toward conglomerate expansion and holding company control of railroads in the light of general public policy toward conglomerates, the ICC practitioners journal.

That author writes in the same article about the simple means of erosion of carrier assets by excessive payment for managerial services, sale of assets to affiliates at less then true value, spin-off of profitable subsidiaries by stock dividends, drain of carrier assets through dividends, use of carrier tax credits in a consolidated return without a consideration flowing to the carrier, and undue contracts due to lack of arms' length bargaining.

THE B.N. FRISCO MERGER FAILS TO SHOW A SINGLE INTEGRATED SYSTEM.

The moribund ICC has consistently held that irrespective of the number of separate carriers, the large holding companies can be held to operate a single, integrated system. A typical example is the recent merger of the Colorado and Southern Railway into the Burlington Northern Railroad Company, 1981. The joint petition of the C&S and the BN points out that the B.N.R.R. owns 92.57 percent of the stock of the C&S and that the C&S wholly owns the Fort Worth and Denver. The minority stockholders in the C&S were ignored by the ICC. The interesting area is the Commission's ignoring the terms and conditions of the lease between the C&S and the FWD. On the merger of the C&S into the B.N.R.R., the parent corporation would then transfer operation to the FWD of former C&S trackage from Denver, Colorado to Texline, Texas. That lease will empower the FWD to manage trains originating and terminating in Denver and Fort Worth, Texas as opposed to severing the community of operation at Texline. While the petition contends that the transaction will be within the B.N.R.R. corporate family, the FWD will publish the appropriate tariffs and will achieve a greater operating efficiency through transportation service by the operation of the single carrier, FWD from Denver to Galveston, Texas. While the petition seems to represent that the FWD will be an integrated part of the single, integrated system, exhibit C attached to the petition is the proposed lease between the B.N.R.R. and the lessee, the FWD. The FWD would lease certain properties from the B.N.R.R., including the lines of railroad, properties, and appurtenances adjunct thereto. With respect to the lines of railroad, the terms are described as follows, on page 3, Article 2--Demised Premises, Section A:

> A. For the sole and exclusive use of the lessee, that certain line of railroad extending northward from the present junction between Lessee and the Colorado Company at the point where said railroad intersects the new Mexico-Texas state borders (sic) near Texline, Texas * * *
>
> B. For use in common with the Denver Company in accordance with the terms of that certain agreement between the Colorado Company and the Denver Company * * * that certain line of the Colorado Company's railroad extending northward* * *.
>
> C. For use in common with the Atchison Company in accordance with the terms of that certain agreement * * * the trackage and properties of the Colorado Company extending northward * * *.
>
> D. For use in common with the Atchison Company and the Wyoming Company, in accordance with the terms of that certain agreement * * *,the trackage and properties jointly owned by the Colorado Company and the Atchison Company in the vicinity of Minnequa, Colorado, and used to serve the public service company of Colorado's generating plant near Minnequa, Colorad.

The lessee, FWD, agreed to pay rent to the B.N.R.R. at the rate of one-twelfth of ten percent of $26,695,000. The FWD agrees to assume the cost of all taxes and special assessments levied against the Texline section. It agreed to maintain the Texline section in the condition as existed on the date of the lease. It may make such additions as desired or found necessary but not to breach any mortgage or other financial arrangements encumbering the Texline section. The costs shall be borne solely by the lessee. That lessee will own and have the right to remove any additions or betterments made by it or at its expense so long as the removing would not cause the Texline section to be less serviceable or cause a default on financial obligations. Although the B.N. consistently argues that it operates all of its railroad companies, except for the switching and terminal companies, as an integrated unit, look at the FWD-B.N.R.R. lease provisions regarding liability:

> The lessee shall and hereby does indemnify and hold harmless lessor from and against any and all damages arising out of injury to or death of persons, or loss or destruction of or damage to property in any way connected with a lease of the Texline section to leasee, the assignment of the aforesaid agreements pertaining to the Texline section or operations of the same, the operations by leasee or others over or upon the Texline section, or in any manner connected with the existence of the Texline section.

The lease provided for a joint operation of the lessee's trains with the Atchison Company over certain trackage. The employees on the Denver section shall be considered joint employees of the B.N. and the FWD, although the road employees would be considered sole employees of the B.N. As to liability for injury or death relating to the employees of the FWD, including the joint employees, on the Denver section, liability is attached to the employer of the sole employee who was negligent; the liability would be borne by each party as to its property and employees when the liability was attributable to the concurring negligence of several parties. With regard to the Denver terminal services, the B.N. will hold the FWD harmless from liability. In the verified statement from Morgan Stanley and Co., Inc., investment banker, on the C&S, B.N. merger petition, the merger was described as follows:

> Such merger would terminate the separate corporate existence of C&S; Fort Worth and Denver Railway Company, now a wholly owned subsidiary of C&S, would become a wholly owned subsidiary of B.N.R.R.

In response to our petition with the ICC, the B.N. verified replies stated:

> While it is clear that control may be found in blocks constituting less than 10 percent of the voting securities where there are no other large blocks* * * control can only be found where there is power or authority to manage, direct, superintend, restrict, regulate, govern, administer or oversee. Reply, page 9.

In the petition for the merger of the B.N. and the Frisco, in the application, Section 1111.1(c)(8), the B.N. stated it exercised control over carriers as follows, to the extent, and in the manner shown. It then described the control or ownership from 7.69 percent of the Belt Railway Company to 100 percent of other carriers. The Frisco exercised controls subject to the act in varying degrees from 2.44 percent of the Trailer Train Company to 100 percent in the Quanah, Acme and Pacific R. R. Co. The additional complicating factor is that the B.N. owns 100 percent of the capital stock of the Burlington Northern Air Freight, Inc., an air freight forwarder and also a trucking company. The Frisco also owns a trucking company.

The Burlington Northern brought into the Frisco merger the following percent of stock in the folloiwng railroad companies:

Name of Carrier	Extent of Control or Ownership (% of Voting Shares)
The Belt Railway Company of Chicago	7.69
Burlington Northern (Manitoba) Limited	100.00
Burlington Northern Dock Corporation	100.00
BN Transport Inc.	100.00
Butte Pipe Line Company	10.00
Camas Prairie Railroad Company	50.00
Chicago Union Station Company	25.00
The Colorado and Southern Railway Company (C&S)	90.57

Name of Carrier	Extent of Control or Ownership (% of Voting Shares)
Davenport, Rock Island and North Western Railway Company	50.00
Delta Alaska Terminal Ltd.	66.67
Denver Union Terminal Railway Company	16.67
Denver Union Terminal Railway Company	16.67
Fort Worth and Denver Railway Company (FW&D)	99.97
Galveston Terminal Railway Company	50.00
Houston Belt and Terminal Railway Company	12.50
Illinois Terminal Railroad Company	9.09
Iowa Transfer Railway Company	25.00
Kansas City Terminal Railway Company	8.34
Keokuk Union Depot Company	40.00
The Lake Superior Terminal and Transfer Railway Company	66.67
Longview Switching Company	33.33
Minnesota Transfer Railway Company	33.33
National Railroad Passenger Corporation	36.00
Oregon Electric Railway Company	100.00
Oregon Trunk Railway	100.00
Paducah and Illinois Railroad Company	33.33
Portal Pipe Line Company	50.00
Portland Terinal Railroad Company	40.00

Name of Carrier	Extent of Control or Ownership (% of Voting Shares)
Pueblo Union Depot	25.00
The Pullman Company	2.97
The St. Paul Union Depot Company	40.20
Spokane, Portland and Seattle Railway Company (leased and operated by BN)	100.00
Terminal Railroad Association of St. Louis	6.25
Trailer Train Company	7.32
Walla Walla Valley Railroad Company	100.00
Western Fruit Express Company	97.14
Winona Bridge Railway Company	66.7

The Frisco brought into the Burlington Northern the following ownership of the listed railroads:

Name of Carrier	Extent of Control or Ownership (% of Voting Shares)
Terminal Railroad Association of St. Louis	6.25
Illinois Terminal Railway Company	9.09
Kansas City Terminal Railway Company	8.33-1/3
The Pullman Company	1.1562
Quanah, Acme and Pacific Railroad Company	100.00
Trailer Train Company	2.44
Wichita Union Terminal Railway Company	33.33-1/3
Frisco Transportation Company	100.00

The Frisco merger order points out that the B.N. owns 18 non-carrier companies, and the Frisco has 4 non-carrier companies. 360 ICC at 797,800. The B.N. properties were valued at $3,451,013.257. Frisco's properties were valued at $673,962,652.

It is inconceivable on the basis of the record that the ICC could wihtout any further evidence, conclude that there is a single, integrated system. Furthermore, there has never been any validation from statutory analysis of the principle that two or more subsidiary, separately certificated corporations operating in a single system should eliminate the imposition of the Interstate Commerce Act from being applied to the holding company.

From a review of the papers filed by the Frisco and the B.N. for their merger, it is a bit difficult to understand just how it is that the Commission concludes that there is a single, integrated system. First of all, they own two separate motor carriers, the B.N. Transport, Inc. and Frisco Transportation Company.

With respect to the listing of the companies, the application, p. 22, asserts that the B.N. exercises control over its carriers to the extent and in the manner shown, which apparently refers solely to percentages. The Frisco exercised control over the carriers in percentages. There is no particular delineation of the nature and extent of control, the reciprocal rights and liabilities, the rights to indemnification, or the manner in which the details of the integrated system are accomplished. Indeed, the application, p. 25, states "the extent to which applicants are a part of a system or group of corporations or other persons is shown in paragraphs C7 and 8 above." That uninformative paragraph merely points out that neither the B.N. nor the Frisco is controlled by any other corporation and that the B.N. exercises control over carriers to the extent and in the manner shown.

As to the terminal companies, the B.N. and the Frisco had certain officers or directors in common, the Illinois Terminal, Kansas City Terminal, Terminal Railroad Assn. of St. Louis, American Rail Box Co., and Trailer Train Co. They then point out that the American Rail Box is a subsidiary of Trailer Train.

The application refers to the consolidated system on page 58. It adds, p. 59, "second, there will be a synergistic effect which will result from the combination of the two fleets, because the combined fleet no longer will be subject to car service rules anywhere on the lines of the merged company." Anyone who understands the synergistic effect and believes that the merger resulted in it should re-evaluate the record.

An example is their verified statement, Volume 7 of the application, December 28, 1977, by C.M. Illg, Assistant Vice-President--Labor Relations, B.N. He said that the primary purpose of the merger was to improve quality and efficiency of the services and that "therefore, while any merger of two companies requires some realignment of forces, this transaction is not intended to result in substantial permanent reductions in employment." When a lay-off occurs, it frequently makes no difference to the employee whether it is permanent or temporary, for when the lay-off is for a long enough time, the person has to seek employment elsewhere. The frustration of the employees should be understandable when there are large lay-offs in various terminals throughout the property.

In the ICC Order approving the Frisco merger, it gave short shrift to the determination of the integrated system. It pointed out that the B.N. owned 100 percent of 7 carriers and directly or indirectly some stock in 29 carriers. Of the latter, the percentages ranged from 2.97 percent in the Pullman Company to 97.14 percent in the Western Fruit Express Co. In addition, the B.N. owned 13 non-carrier companies. 360 ICC at 797. The Frisco, on the other hand, owns 100 percent of a motor carrier, the Frisco Transportation Co. and the QAP, a rail line in the Texas panhandle in connection with the Santa Fe. It has an interest in eight other carriers with a range from

1.1562 percent in the Pullman Company to one-third of the Wichita Union Terminal Railway Company, as well as the Frisco Transportation Co., 100 percent, and the Pacific Railroad Co. It owned four non-carrier companies.

The purported insight of the ICC initiated the discussion with the following remark:

> We begin the decade of the 1980's faced with an economy suffering the ravages of inflation and an uncertain future as to the reliability of our energy resources. The Interstate Commerce Commission cannot cure these problems. However, our decision regarding surface transportation can incrementally reduce these problems. A basic ingredient in the price of all goods is transportation, and the basic ingredient of our nation's transportation system is energy. 360 ICC at 934.

The suggestion to the ICC that its decision would incrementally reduce problems seems not to be borne out by the record. This involved a merger of two very healthy railroad corporations, and the merger was contemporaneous with the gradual demise of the Milwaukee Road and of the Rock Island. Yet, the Commission said that "competition will be enhanced by carriers willing to go the extra mile to show shippers that their service is or can be as good as that of the merged company." 360 ICC at 941. The unfortunate metaphor has no relationship to any decisive increase in competition. The Commission, however said that "approval of this merger will not adversely diminish competition." 360 ICC at 941. While perhaps the merger did not diminish competition, we know that the competitors have been adversely affected, and it is impossible to understand that the merger increased competition. Instead of merging with carriers in severe financial condition, the Commission allowed the merger of healthy companies, at the obvious expense of the weaker carriers.

The Commission, we thought, clearly stated its position on the holding company. It stated:

> The ability of a railroad to satisfactorily provide transportation services and to adequately rehabilitate its plant and equipment can be affected by its corporate structure. Those in a position to control a railroad's actions can divert the carrier's income, property, and other assets for non-rail purposes. This opportunity exists to a significant degree when a parent holding company controls the railroad.
>
> B.N. will not be in a position to form a holding company for many years due to bond indenture restrictions. Therefore, the opportunity for a diversion of assets to other sources does not presently exist. Also, the current management of B.N. appears to be fully dedicated to railroad operations. 360 ICC at 992-993.

The Commission was not above articulating a non sequitur. In discussing the expenditures for the locomotive fleet, it pointed out that that fleet had remained stable since 1970. Since 1972, 36 locomotives have been leased. In 1977, the Frisco reduced its own fleet by four locomotives. The ICC then made this observation: "Reduction in the locomotive fleet could be a result of the carrier's efforts to concentrate on saving fuel more accurately by calculating the amount of horsepower required." 360 ICC at 1015. The more logical point is that the Frisco just did not make the investment. The Commission on the following page pointed out that the Frisco had consistently had a maintenance of equipment ratio investment below the industry average. The locomotive bad orders was rather high as of 1977, a decline which began in 1976. However, productivity had increased steadily from 1970 to 1976, a total increase of 21.9 percent. Ibid at 1016.

The ICC pointed out that the budgeted maintenance for roadways may be curtailed. It then added this comment:

> Nevertheless, the operation of freight cars over a right-of-way contributes to the deterioriation of the roadbed and track structure, necessitating periodic expenditures to restore these basic items to a useable condition. A permanent loss of the diverted cars, including related empty car movement, contributes to a deceleration of the deterioriation, thus, saving funds otherwise required for roadway

maintenance. 360 ICC at 1107.

What the Commission seems to be saying is that a reduction in traffic is better because it decelerates the deterioriation. However, the railroad is designed for traffic and to transport materials. It appears to be an implicit recognition that the carriers when merged will reduce their railroad investment. That, of course, is exactly what has occurred since the effectiveness of the merger in 1981.

It is impossible for some of us in railway labor to recognize any great improvement in the corporate structure or the improvement of the carriers commitment to national rail transportation by a merger which is immediately transformed into an economic opportunity to remove the railroad assets.

In our petition to the ICC to investigate the formation of the holding company, the Commission was told by the carrier in its reply that:

> In the case of those rail carriers listed in railroads R-1 as controlled to the extent of more than 50 percent by Railroad, all are completely integrated with the railroad. As stated in the statement, the capital budgets and performance plans are either established or approved annually by railroad. The accounts of each such carrier are directed by railroad and are consolidated with the accounts of railroad for financial reporting purposes. Each deposits cash in and withdraws cash from a railroad surplus cash account. Motive power is assigned for each by railroad. Railroad solicits traffic for such carriers and does not solicit traffic in competition with them. The Board of Directors of each of such carriers is elected by railroad and consists of directors and officers of railroad or employees of such carrier, and many of the executive officers of such carriers are also officers or employees of railroad.

The fair inference, of course, is that those companies which are owned up to 50 percent by the B.N. are not completely integrated with the railroad. Along that line, the reply stated the following:

> Railroad also has interests, ranging from 50 percent to 1.16 percent, and numerous other carriers subject to the jurisdiction of the Commission. While it is

> clear that control may be found in blocks constituting less than 10 percent of the voting securities where there are no other large blocks, * * * control can only be found where there is power or authority to manage, direct, superintend, restrict, regulate, govern, administer or oversee. * * *
>
> In the case of those carriers in which railroad has a 50 percent interest, the other 50 percent is owned by one other, unaffiliated carrier. In the case of carriers in which railroad has a less than 50 percent interest, the other interests are owned by several other carriers. In some cases, railroad may own a larger interest in such carriers than do the other owners as a result of its acquisition of the interests of the former Frisco. But in no case does railroad have the power to control such carriers. Clearly, if the railroad were to attempt to impose policies on such carriers which were detrimental to the interests of the other owners, such other owners together would have the power to defeat such attempted control. Railroad submits that as only a single owner, it does not control those carriers in which it owns a 50 percent or less interest. It follows that if railroad does not control such carriers, acquisition of railroad by a Holding Company will not result in the acquisition of indirect control of such other carriers by Holding Company.

This last paragraph should have given the ICC some very serious problems. First of all, if the B.N. owns 50 percent of an unaffiliated carrier, as it concedes, it certainly has equal control; and the significant factor is that the statutes do not state exclusive control.

Section 11343 of the Act provides Commission jurisdiction over a company not a carrier if it acquires control of at least two carriers. A 50 percent interest in a carrier must give at least equal control, and the B.N. in its reply to our petition stated that it does have 50 percent interest in companies owned by other, unaffiliated carriers. While it concedes, in the reply on page 9, that control may be found with just 10 percent of the voting interest, so long as other carriers do not exceed that percentage, it contends that its ownership of a minority interest greater than any other does not give the power to control. Reply, p. 10.

More serious than the railroad's contention is the ignoring of this issue by the Commission.

The ICC tells the Congress that it has the power to exercise jurisdiction over a company owning two or more carriers, irrespective of whether they are an integrated system, and then consistently refuses to exercise that power. The enormous railroad investment by the B.N., coupled with the extensive trackage throughout the nation under the influence or, as we submit, the control of the B.N. makes the centralized control by an unregulated corporation a very serious national concern. If the assets be transferred from the railroad, without compensation, to a holding company and its other subsidiaries which are not subject to the Interstate Commerce Act and therefore need not be invested in a manner consistent with the railroad operation, we may have here a large and historically important railroad system severely jeopardized in the next decade by economic privation. This should create a deep congressional concern which would be expressed in a determination as to whether the ICC is actually performing its legislative duty.

CONCLUSION

We realize that there are many arguments for holding companies and we acknowledge the management must have its right to manage. But we do believe very deeply that the national commitment through land grants was to the railroad transportation system, not to banks, not to financiers, and not to separate profit centers dissociated from the railroad industry. The Penn Central at one time was the leading railroad land owner in the United States, with its holdings reaching $1 billion. Yet, it went cash broke. It was a railroad severed thereafter from the financial institution, and the railway transportation has deteriorated ever since. Yet, the other assets are a phenomenal investment in a very healthy corporation.[1] It was a railroad that owned 100 percent of the Buckeye Pipeline, which distributed oil products over a 7,600 mile system. [2] It had an executive aircraft system, as well as other investments. Yet, it went cash broke.

The Chicago Milwaukee has been substantially destroyed. Its parent corporation continues to sell off the land, and the stock of the company has been doing very well for the last two years. In 1981, the Milwaukee sold 93,000 acres of timber land in Idaho for $134.8 million. A second land sale t $45 million in Washington was closed. A third land sale of $100 million was planned. Richard B. Ogilvie, trustee for this bankrupt railroad, was quoted in the Wall Street Journal of April 14, 1981 that "we're the hottest game in town."

All that may be well and good for the Milwaukee shareholders, but it is a tragic commentary on national railway transportation syste

The Norfolk & Western Railway Company recently gave to the University of Virginia its Erie Lackawanna Railway Division, for nothing. See the Wall Street Journal, January 28, 1982. Richard W. Haigh, the dean of Universities Darden Graduate School of Business Administration had the gall to accept this "down side risk" because it had some "upside potential." He said that he liked to play the odds. The hazard, of course, was that the school could become liable for the millions of dollars of claims. If, on the other hand, the railway emerged from bankruptcy, the school could make a profit. The N&W would get rid of an emormous liability of up to $500 million. Such is our academic institutions of today.

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[1] The Interstate Commerce Omission, p. 406

[2] The Interstate Commerce Omission, p. 408

The Burlingtom Northern in its 1980 report indicated current payable state and federal taxes of $42,137,000, with an additional deferred tax liability of $42,632,000. That $84 million tax liability was severely affected by last year's tax changes which provided for sales of tax credits. In the railway periodical, Labor, December 16, 1981, it was reported that the B.N. would not be paying much of anything in taxes after selling its excess tax breaks to several companies, including E.F. Hutton Group, Inc. The B.N. received $36 million for the tax breaks which it sold over on top of what it used to reduce its own tax liability.

It is difficult to understand how the national transportation system, or the railroad employees, benefit. The Chicago Tribune on May 31, 1981 reported that the nation of Kuwait in its account managed by Citibank owned 140,908 shares of stock in the B.N. at a then market value, December, 1980, of $9,528,903. It also owned 500 shares in the UP Corp. at a market value of $37,000,000. The Minneapolis Tribune, May 31, 1981, reported that the chairman of the B.N., Louis W. Mink, received income of $439,643, the new president, Richard Bressler, received income of $508,333.00 and the chairman of the Executive Committee, N. Lorentzsen, received $522,361. In addition, Mr. Bressler received an unsecured, non-interest bearing loan of $450,000 and a $1,014,687 gain on 25,000 shares of B.N. stock which he purchased for $2,500. In addition to those benefits, the carrier paid cash based on the value of stock options without requiring the executive to exercise its stock option. Mr. Mink received $725,625 in 1980.

It is very difficult to understand how this rapacious appetite can be sated. The railroad receives no benefit from a diversion of its assets to other profit centers. The tragic history of governmental regulatory efforts has resulted in a debacle like the DC 10 in Chicago, the Three Mile Island in Pennsylvania, the Penn Central, the Rock Island, the Milwaukee Road. We hope it does not hit the Burlington Northern.

There is no sin or crime in bigness. We have no agreement with the statute which forbad a railway across the Romagna on the ground that "railways produce commerce, and commerce produces sin." That was in 1851.[3]

Planned obsolescence destroyed the railroad passenger service. In 1959, 50 percent of the passenger coaches were 30 years of age or older. Only 7 percent fewer than 5 years. In 1968, shortly before Amtrak took over, the average age of passenger coaches was 18 years on the Great Northern; 15 years on the UP; and 34 years on the Illinois Central. Yet, a new coach involves only one-sixth of the cost of maintenance compared to the older coaches.

In 1967, of 76 Class I rail carriers, in 15, the stock was owned by fewer than 10 individuals. In 25 of the carriers, the stock was owned by fewer than 50 persons. Thirty-seven of the major carriers were owned by fewer than 1,000 shareholders. It is not known that the ICC has ever made any attempt to find out who owns which railroads and what the interlocking directorate relationships might be.

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[3] Freedom and Organization, 1814-1914, Chapter XXVIII, p. 401

The destruction of the railway system would not be an increased efficiency. In the letter to the Environment Magazine from Steve Roberts of Monrovia, California, we learned that three-quarters of a horsepower may generate a rail ton mile on a level track at 25 miles per hour. This is a very high fuel efficiency. Furthermore, the railroad right of ways are already in and would involve an astronominal cost for replacement. Yet, railroad maintenance is down. As to land use,

> In 24 hours, a four lane freeway can carry 216,000 tons of freight in 18,000 trucks each carrying 12 tons. In 24 hours a double track rail line with centralized traffic control can carry 774,000 tons of freight in 18,000 freight cars each carrying 43 tons.
>
> One track of railroad can carry 48,000 persons an hour. One lane of freeway can move only about 12,000 persons per hour. A four lane freeway with a 300 foot right of way uses 3,636 acres of land per 100 route miles. A double track railroad with a 75 foot right of way uses only 911 acres per 100 miles.
>
> Chicago's O'Hare International Airport has a 6,500 acre site handling the 25,000,000 passengers that arrive and depart in a year. The three New York airports have 7,800 acres to handle 30,000,000 yearly passengers. New York's Penn Station handles 62.2 million year passengers on just 82 acres of land, much of it underground. Grand Central Station handles 42.8 million passengers on 42 acres of land. Penn Station and Grand Central in New York occupy 124 acres of land and accommodate 105 million yearly passengers. Also, much of the underground rail terminal's air space is covered with productive high rise office buildings.
>
> A double track railroad 722 miles long with a 75 foot right of way could be built using the same amount of land (6,500 acres) as Chicago's O'Hare International Airport. An 864 mile, long double track railroad with a 75 foot right of way could be built with the 7,800 acres of the three New York airports.

From the standpoint of the national investment in development of the economy of this country in the settlement of the West and from the standpoint of the economic use of land, both metropolitan and rural, and from the standpoint of need for transportation, and the irreplaceable investment that has already been made, the Congress should enact additional legislation to mandate that the Interstate Commerce Commission actually will provide for the national transportation system. The ICC has done an incompetent job, and it seems to be rather obvious. Whether that is a product of incompetence in the Commission, lack of proper methodology in its personnel, or a pre-disposition to an approval of mergers irrespective of their results, we should turn back on them the phrase in the Frisco merger and require a "deceleration of deterioriation.

Senator **Baucus**. Next, we will hear from Dan Smith, for the Citizens' Committee to Save the Land Grant Railroads, and Pete Pallipamu, chairman of the Railway Intercraft Association, also of Seattle.

Mr. Smith, why don't you proceed first?

STATEMENT OF A PANEL INCLUDING DANIEL H. SMITH, ATTORNEY, ON BEHALF OF CITIZENS' COMMITTEE TO SAVE THE LAND GRANT RAILROADS; AND PETER PALLIPAMU, CHAIRMAN, RAILWAY INTERCRAFT ASSOCIATION

Mr. **Smith**. Thank you very much, Mr. Chairman. I understand that the statements that we have submitted will be included in the record, but I would like to make a few brief comments on other matters that have come up.

As I indicated in my statement, I am here because I have been representing the Citizens' Committee to Save the Land Grant Railroads, in litigation that we have undertaken in Seattle, on behalf of the Citizens' Committee and a number of labor organizations, which is now pending before the Ninth Circuit Court of Appeals.

I would like to say that we really appreciate the hearings that you are having here today. There is a great deal of concern in the Northwest about our rail transportation system, and in these days of great international crises and budget problems here in Washington, we have not heard much about any actions to do anything about the crumbling of the transportation infrastructure of this country that has taken place in the last 10 years, and the real jeopardy that we feel recent actions of Burlington Northern management put the future of the Northwest railroads in.

It is encouraging and exciting to have these hearings now, and we hope that they are just the first step in real action to follow up on the problems that are being exposed.

RAILROAD "INDEPENDENCE" FROM NATURAL RESOURCE SPINOFFS

We reject as totally unconvincing Mr. Bressler's remarkable new claim that the BN was reorgainzed into a holding company in order to solve some problems in recruiting executives, or to modernize certain ineffective management structures.

The original, more candid, admission in the BN proxy statement revealed that the true motivation for the holding ICC regulation. What is the restriction Mr. Bressler finds so intolerable? The ICC rule is simply that corporate financing plans must be consistent with the railroad's transportation obligations to the public.

All of us who rely on the future of the railroad are naturally distrubed by this effort by BN to be freed from any responsibility to the public. What mechanism will prevent the holding company from undermining the railroad by siphoning off its vast natural resources?

Mr. Bressler's answer to the questions that are being raised is very simple. He says what is good for Burlington Northern is good for everybody. I think the Congress, in its creation of the regulation of the railroad industry, realized that this is not true; that when we have a Government created monopoly and a vastly Government-subsidized monopoly, that it is not enough, like other private corporations, to let the corporation rise or fall based on the wisdom of its management or the profitability to the stockholders. In a nonmonopoly situation, presumably, if the management makes poor decisions, if the capital flows elsewhere, and this creates a need, then new capital will flow in, and a new company will enter this market. However if the railroads go, it is clear, and I think everyone would agree, it would be financially unfeasible to replace them at this point. So the public interest requires not just a holding company saying "let the railroad stand or fall on its own," but requires that Congress do what is necessary to make sure that the railroad stands.

ICC JURISDICTION

Our first recommendation is that the ICC should reconsider and abandon their single-system doctrine. It is irrational for ICC jurisdiction to depend on the technical question of whether Burlington Northern holding company or Burlington Northern Railroad controls a few terminals or switchyards that are peripheral to the main issues of the national interest of the transportation system.

The single-system doctrine makes sense only as it relates to one-half of the ICC's mission to protect against anticompetitive measures. That is only one-half of its mission—as it relates to competition. But the public interest in transportation services is a totally different concern, and sometimes a competing concern, with continued competition. I think that the single-carrier doctrine ignores all of the dangers recognized by the ICC itself in its 1977 study, from a noncarrier control and noncarrier decisionmaking as to the disposition of a carrier's assets, and a holding company presents those dangers in classic form.

TIMING OF MERGER

And we have an added consideration here with the land grant issues, which I will get to in a minute. But I appreciate it being pointed out earlier today that the timing of the ICC consideration was very crucial here. Again, ICC jurisdiction should not depend on the timing. If there were an application filed with the ICC for a noncarrier—namely, the holding company—to acquire control of two massive railroad systems—namely, Burlington Northern and the Frisco system—clearly, the ICC would have had jurisdiction. There were two separate systems that the holding company was seeking to acquire, but because the method was first merger, then holding company formation, their strategy succeeded to escape ICC jurisdiction. If the timing sequence had been slightly different by a matter of months, then the ICC would have had jurisdiction. We think that that is a clear end run around the public interest in regulation and supervision and is contrary to what the whole purpose of having ICC involvement in this area should be.

PURPOSE OF LAND GRANTS

Now, with the land grant, as was noted this morning, there are people who strongly disagree with the position that Burlington Northern has taken, that it has no public obligations arising out of the land grants it was given. Starting with the language of the statute itself, as we pointed out in our brief which is on the record, it was stated that the purpose of the land grant was not only to construct the railroad, but also to keep it in working order, and to secure to the Government at all times, but particularly in time of war, the uses and benefits of the same. And in that language, it seems to me it is clear it is not just a construction grant, but to provide a financial land base for a transportation system in perpetuity.

We think that further hearings are essential. I welcome your proposed legislation that should require complete monitoring and accounting for the proceeds of all those land grants and a monitoring right now of every transaction between the railroad and the holding company. And we believe that the standard applied by the ICC—whether the holding company decisions are consistent with their service to the public as a common carrier—should be imposed on the holding company itself; that is the minimum necessary to protect the public interest in the continued transportation system.

Thank you.

Senator Baucus. Thank you very much, Dan. By the way, you mentioned you have a brief that you would like to have included in the record; is that correct?

Mr. Smith. Yes, I would. I did submit that by mail last week.

Senator Baucus. Fine, that will be included.

[The following was received for the record:]

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

CITIZENS COMMITTEE TO SAVE THE LAND GRANT RAILROADS (C.C.S.L.G.R.); et al.,

Plaintiffs,

vs.

BURLINGTON NORTHERN, INC., et al.,

Defendants.

NO. 81-566V

PLAINTIFFS' BRIEF OPPOSING MOTION TO DISMISS

I. INTRODUCTION.

This is a new case, but it arises out of an old controversy--one which has lasted over a century. From 1850 through the 1860's Congress showered the railroad magnates with "lavish grants from the public domain." United States v. Union Pacific, 353 U.S. 112, 125 (1957). But by the end of this period, "the mood of uncritical enthusiasm toward railroad enterprises began to veer." Id. "This policy [of 'lavish grants'] incurred great public disfavor. . . ." Great Northern v. United States, 315 U.S. 262, 273 (1941).

Since then, the courts have been vigilant against the excessive claims of the railroads. The provisions of the land grants are to be construed strictly against the railroads. Barden v. Northern Pacific, 154 U.S. 288 (1893). "Nothing passes except what is conveyed in clear language," and any doubts are to be resolved against the beneficiary of the grant. Caldwell v. United States, 250 U.S. 14, 20 (1919). Thus rights and titles claimed by the railroads or their successors are to be limited to the express provisions of the grants. And where necessary to accomplish the Congressional purpose for the land grants, limitations and conditions are read into the titles to these lands, even lands held in fee by the railroads: "a limited fee, made on an implied condition." Northern Pacific v. Townsend, 190 U.S. 267 (1903). "In view of this lavish policy of grants from the public domain, it is not surprising that the rights of way conveyed in such land grant acts have been held to be limited fees." Great Northern v. United States, 315 U.S. at 273.

The Defendants in this action have particular duties and obligations arising out of their status as a "quasi-public" corporation. Woodstock Iron Company v. Extension Company, 129 U.S. 643, 656 (1889):

> Railroads are for many purposes public highways. . . . Corporations, it is true, formed for their construction are private corporations, but whilst their directors are required to look to the interests of their stockholders, they must do so in subordination to and in connnection with the public interests, which they are equally bound to respect and subserve. All arrangements, therefore, by which directors or stockholders or other persons may acquire gain, by inducing those corporations to disregard their duties to the public are illegal. . . .

See also Northern Pacific v. State, 84 Wash. 510, 523 (1915):

> [L]et us keep in mind as we proceed that appellant is not a private business concern, but is a public service transportation corporation; . . . that appellant cannot abandon its duty to serve the public, nor can it dispose of its property real or personal in such a manner as to result in discontinuance of such service; that appellant and its successors in ownership of such property are bound to maintain such service, and incidentally to maintain an organized entity necessarily consisting of equipment and operating property, both real and personal, as a unit organization such as will make the rendering of such service possible.

The public purpose of the land grant is clear on the face of the statute:". . . to accomplish the object of this Act, namely, to promote the public interest and welfare by the construction of said railroad and telegraph line, and keeping the same in working order. . . ." Section 20, 13 Stat. 365 (N.P. Grant of 1864).

The federal interest in interstate communications and transportation is so strong and the legislation regulating such companies is so comprehensive that federal law gives a remedy for wrongs committed by these carriers, even when the statutes provide no such remedy, either expressly or implicitly. Ivy Broadcasting Company v. American Tel. & Tel., 391 F.2d 486 (2d Cir. 1968). See also Kohr v. Alleghany Airlines Inc., 504 F.2d 400 (7th Cir. 1974), cert. denied 421 U.S. 978 (1975). And see the further discussion of bases for jurisdiction below.

Under these principles, Plaintiffs complain that Defendants are in the middle of a planned course of action which illegally threatens grave and direct injury to their personal and economic interests, as well as the public interest. Defendants have moved to dismiss this Complaint pursuant to Rule 12. In support of their motion, Defendants repeat the denials, already made in their Answer, that their actions are wrongful, and likewise their denials that the Plaintiffs will be injured. These denials, of course, raise issues of material fact, which will eventually be decided by the court after the parties have had the opportunity to pursue the discovery provided by the Federal Rules and the opportunity to present evidence in support of their allegations. For the purposes of this Motion, however, the allegations of the Complaint must be taken as true, together with all reasonable inferences which may be drawn in Plaintiffs' favor.[1] We will now turn to the particular arguments that the Defendants make in support of their assertion that Plaintiffs have failed to state a claim upon which relief can be granted.

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[1] "[A] complaint should not be dismissed for insufficiency unless it appears to a certainty that plaintiff is entitled to no relief under any state of facts which could be proved in support of the claim." 2A Moore's Fed.Prac. §12.08.

II. MOOTNESS.

It is easy to understand why moot cases are held to be beyond the judicial power. There is no case or controversy once the matter has been resolved. California v. San Pablo, 149 U.S. 308 (1893). If anything is clear about this case, it is that the matter has not been resolved. The Complaint asks for, among other things, an injunction "until the Interstate Commerce Commission has had the opportunity to fully investigate and rule on the legality and propriety and effect on the interests of the public, the employees, and on the national transportation system, of the proposed actions of Burlington Northern." No such ruling on the merits of Plaintiffs' claims has yet been made by the Interstate Commerce Commission. Rather, the Commission declined to exercise its jurisdiction, provided by statute, to review the propriety and the legality of the reorganization, on the basis of the administratively developed "single carrier doctrine." This abdication of responsibility by the ICC is now on review before the Circuit Court of Appeals. The case and controversy remains at issue. It has not been resolved or otherwise abated.

Furthermore, should Plaintiffs prevail on the request for relief stated in paragraph 1 of the prayer, at page 12, declaring the proposed reorganization plan to be illegal, injunctive relief would surely be proper under the request in paragraph 3 of the prayer for whatever relief is necessary for protection of the legal interests asserted by Plaintiffs. Thus, the doctrine of mootness is interesting but certainly does not dispose of Plaintiffs' challenge to the legality of Defendants' reorganization scheme.

III. PLAINTIFFS' COMPLAINT STATES A VALID CAUSE OF ACTION UNDER THE 1864 NORTHERN PACIFIC LAND GRANT ACT.

A. Introduction.

Defendants' Motion to Dismiss raises numerous questions of fact and law and as a whole constitutes a broad-side attack on Plaintiffs' "Land Grant Theory" and also the numerous jurisdictional bases for federal court review of our claims. In this response Plaintiffs will establish:

(1) The historical context and legislative intent of the Northern Pacific Land Grant Act of July 2, 1864;

(2) The economic injury to Plaintiffs which we claim results directly from the creation of a holding company and Burlington Northern's plans to transfer non-railroad assets to that holding company; and

(3) The jurisdictional bases of Plaintiffs' causes of action.

B. It Was The Clear Intent Of Congress In Creating The Northern Pacific Railroad Company And In Granting It Over Forty Million Acres of Public Lands To Insure That The Land Grant And Its Resource Base Would Always Be Available To Insure The Financial Stability And Continued Operation of That Railroad.

By the Act of July 2, 1864, C. 217, 13 Stat. 365, Congress created the Northern Pacific Railroad Company as a "body corporate and politic." It commanded the corporation to "lay out, locate, construct, furnish, maintain and enjoy a continuous railroad" from Lake Superior to Puget Sound. The statute granted a 400 foot right-of-way and necessary land for related buidlings and sidetracks. The government committed itself to "extinguish, as rapidly as may be consistent with public policy and the welfare of the . . . Indians, the Indian titles to all lands falling under the operation of this Act . . . ."

The purpose of the Land Grant is succinctly summed up in Section 20:

> [N]amely, to promote the public interest and welfare by the construction of said railroad and telegraph line, and keeping the same in working order,

> and to secure to the government at all times (but particularly in time of war) the uses and benefits of the same. . . .

[Emphasis supplied].

The land grant was, by any conceivable earthly measure, enormous:

> Every alternate section of public land, not mineral, designated by odd numbers, to the amount of twenty alternate sections per mile, on each side of said railroad line . . . through the territories of the United States and the alternate sections of land per mile on each side of said railroad whenever it passes through any State . . . .

This is the equivalent of the right to select, in the territories, 25,600 acres of land for each mile of line, within a 120 mile swath across the country. However, the statute imposed a number of conditions on the grant, conditions which Northern Pacific failed on numerous occasions to comply with, making a mockery of Congressional intent.[2]

By this legislation over 40 million acres of public land was eventually granted to the Northern Pacific Railroad, including 22.4% of the total area of the State of Washington (9.6 million acres out of 42.9 total land area acres) and 23.9% of the State of North Dakota (10.7 million acres out of 44.8 million acres). See Table 1 and Map 1, attached as exhibits hereto.

Although the legislation was part of the 1860's wave of federal land grants to build railroads to the west coast (including grants to the Union Pacific and Southern Pacific Railways), the policy of federal land grants in aid of railroad construction and operations had begun in the 1850's. In the Congressional debates on the first land grants involving the Illinois Central Railway, Senator Seward framed the Congressional intention and purpose of the railroad land grants. He stated that the construction of railways and other internal improvements

> have never been made by mere individual, unassisted

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[2] See Applegate, "An Unintended Empire: A Case Study Of Rail Land Holdings," Rick Applegate, Congressional Aide to Montana Senator Max Baucus, see fn. 3, below.

> enterprise, unless they have been attended by very great delay and embarrassment. A great and extensive country like this has needs of roads and canals earlier than there is an accumulation of private capital . . . to construct them."

Seward noted that those railroads that had been constructed without federal governmental assistance "have all found themselves embarrassed and crippled, and many of them rendered bankrupt." Congressional Globe, Comments of Senator Seward, April 29, 1850, at 851.

Historians have generally concurred that the principal purpose of the land grant acts was to raise and maintain sufficient capital and financial backing to construct and operate the railroads in the public interest. Tied to this overriding purpose were subsidiary interests

(1) to provide for the safe transport of troops and munitions of war;

(2) to encourage the colonization and the economic and social development of the western part of the United States; and

(3) to promote trade with the Orient, especially the cotton trade with China and Japan.[3]

Thus the Act of July 2, 1864, in one legislative enactment, created the Northern Pacific Railroad and empowered it to construct and maintain a railroad. It was for this purpose that it granted enormous land and non-mineral natural resources to the newly created corporation. There is no question that the intent of Congress was to invest this entire project with a profoundly public purpose. Little historical evidence exists to support the view that Congress granted so much land to the railroad for the mere construction of the railroad line. Thus no railroad could have built its line and then immediately have abandoned it and stopped operations in order to pursue more profitable investments in land speculation or natural resources exploitation. The very existence of the Northern Pacific Railroad Company and its corporate successor Burlington Northern was and is inextricably bound up to the continued operation of the railroad free from financial disaster or bankruptcy. It was precisely the land grant that assured the financial base for the continuous operation of the railroad in perpetuity.

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[3] Applegate, "An Unintended Empire, A Case Study of Rail Land Holdings," 1979. Reprinted in Hearings Before Subcommittee on Public Lands, Sept. 17, 1979, 96th Cong. H.R. 3928, 110-241.

Friedman, Federal Aid of the Railroads, Part III, Grants to Public Lands to Railroads. March, 1980.

Hedges, "The Colonization Work of the Northern Pacific Railroad, Vol. XIII, No. 3, The Mississippi Valley Historical Review (Dec. 1926).

Gates, History of Public Land Law Development, Ch. XIV (Wash., D.C. 1968).

Swenson, "Railroad Land Grants: A Chapter in Public Land Law," Utah Law Review, 456 (19).

Thus Burlington Northern comes to this court not as a "private party" invested with the privilege of unilateral discretion in all matters of corporate affairs and disposition of "its" property. To the contrary, Burlington Northern comes to the Court as a Congressionally created, quasi-public corporation, and a recipient of incredible beneficence. Cf., Woodstock Iron, and Northern Pacific v. State, discussed at p. 1 above. It thus carries on its shoulders the historical legacy and solemn duty to uphold the public interest in the continued operation of a financially secure railroad line. If the statute of July 2, 1864 means anything, it means this.

C. Burlington Northern's Holding Company Stragegy Constitutes A Clear And Present Danger To The Plaintiffs' Interest In The Continued Operation Of Essential Rail Services.

> We are particularly concerned that lands which were granted by the Federal Government to railroads to enable them to fund the construction and operation of their rail lines--or the proceeds from the transfer of those lands or of interests in those lands--have been and will be transferred from the railroads to their parent holding companies at less than fair value. Were the railroads receiving these properties, or their railroad successors in interest, to be deprived of the fruits of these land grants, at a time, whether now or in the future, when they are needed to support rail services essential to the public interest, the intention of the Congress in making these grants would be subverted, and today's citizens would lose the benefit

> of the contract made by their forebears with the land-grant railroads.

"Railroad Conglomerates and Other Corporation Structures," Report to Congress, Interstate Commerce Commission, Feb. 5, 1977, at 74.

The findings of the ICC in this study include the following:

1. Holding Company Structures Eliminate Capital Stock Financing by Railroads.

> ". . . The holding company corporate form has effectively eliminated the issuance of capital stock as a means of railroad financing . . . as independent financing units, railroads under the control of diversified holding companies are now limited to the use of internal funds and debt financing to satisfy operating and capital improvement requirements. . . .If, as is probable, the carriers debt to debt plus equity ratio continues to deteriorate, the vulnerability to economic downturn is increased. . . . Ultimately, the railroad can become a burden to the holding company and a candidate for divestiture, as described earlier. Despite assertions of some holding companies of their capability to assist railroads with their capital needs, there is little evidence of such aid at a time when there is such general agreement respecting the railroads' substantial need for capital to meet deferred maintenance and delayed capital improvements. More likely, because of the holding company's profit-center philosophy, its management's decision on use of capital will turn on anticipated yields among competing investment opportunities."

2. The Holding Company Is Designed To Facilitate The Separation of Assets From Railroad Subsidiaries Through Various Practices.

> ". . . Most railroad-formed holding companies depend on development of former railroad assets for purposes of expansion and growth. The railroads once divested of non-carrier assets, remain a non-growth sector or the holding company group.
>
> The railroads as subsidiaries of holding companies, became profit centers affiliated with other, non-carrier profit centers under the umbrella of a non-operating holding company. This is not to say that railroads should not be self-sufficient. Our concern lies in the fact that railroad non-carrier resources and income have been divorced from the railroads in many, if not most, cases without adequate compensation.
>
> As a result, while the stockholder has lost nothing and perhaps has even gained in terms of equity and earnings, the railroad as an instrument of public service has been deprived of wealth accumulated over many years, including resources such as land grants provided at public expense. It is implicit that if the earnings of the railroad are not sufffficient to satisfy the holding company management's perceived obligations to its stockholders, then as little money as possible would be spent on the railroad."

3. The Interests Of Conglomerate Managements And Their Stockholders Diverge From The Public Interest In A Sound Transportation System.

> "We must view the evolution of railroad corporate structures in terms of their preservation and enhancement of private enterprise common carriers responsive to the needs of the shipping public. Contrary to the suggestions of some respondents, on the whole the study found no substantial benefits in terms of improved profitability, maintenance or modernization of the railroads which resulted directly from formation of the holding companies."

On the other hand, "the result of holding company formation has been to enhance the position of present holding company stockholders."

4. The Plan To Make The Railroad "Stand On Its Own Feet" Without Its Land Grant Financial Base Threatens The Railroad's Viability.

The ICC has done an analysis of the financial condition of the major railroads of the United States. With regard to Burlington Northern it found:

> The financial strength of BN is due in large measure to the existence and development of its non-railway assets. The carrier owns in fee nearly 2.4 million acres in the Mountain and Northwestern States and holds mineral rights on an additional 5 million acres. Revenues derived from the mining of taconite, coal and other minerals, the production of oil and gas, and the harvesting of forest products have become important sources of income during recent years.
>
> . . .
>
> BN's future prospects are in large measure dependent upon its natural resources, especially coal. The railroad is only marginally profitable standing alone.

ICC Report, at 51-52.

The ICC study analyzed the reasons given by railroads for holding company reorganizations, and the actual consequences to railroad transportation services, as follows:

5. The Claimed Benefits And Real Detriments Of Holding Companies.

The reasons cited by other railroads for formation of holding companies were identical with those of Burlington Northern in this case. "A common reason was to avoid possible regulation of non-carrier operations." The Interstate Commerce Act requires ICC authority for the issuance of securities, providing that

> The Commission shall make such order only if it finds such issue or assumption: (a) is for some lawful object within its corporate purposes, and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the carrier . . . and which will not impair its ability to perform that service, and (b) is reasonably necessary and appropriate for such purpose.

Former §20a(2) of the Interstate Commerce Act.[4]

> Other primary reasons cited for formation of holding companies include: (1) facilitation of financing at lower interest rates; and, (2) better management of the development of non-carrier resources.
>
> With some exceptions, such motivations appear spurious.
>
> Most of the holding companies formed by railroads had no assets to begin with. They have no financial strength to support financing at any interest rate, much less lower rates. Since the collateral base for subsequent financing comprised assets drawn initially from the railroads, the basis for the claimed benefits of financial support at lower interest rates existed prior to the formation of the holding companies.
>
> The executive managment of the railroads became the executive management of the holding companeis. In most instances the non-carrier enterprises operated with the same staff both before and after the advent of the holding companies.
>
> In short, the holding company concept effected two material changes; the railroads lost many of their non-transportation assets and operations including the income therefrom, while the holding company escaped regulation under §20a.
>
> Alleged benefits to the railroads from the formation of the holding company is supported by little evidence. Rather, as subsidiaries of holding companies, railroads stand in risk of weakened financial strength from loss of previously available non-carrier income from investments and non-carrier resources.

ICC Report, at 10.

6. The Elimination Of Minority Stockholders From The Railroad.

The ICC Report provides a blueprint of the reorganizational manipulations now being engaged in by Burlington Northern solely for the purpose of eliminating minority stockholders in order to shelter their manipulations from attack in the form of derivative suits.

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[4] Burlington Northern apparently finds this limitation impossible to live with, and thus cites its avoidance as a primary motivation for its reorganization plan. Yet, it is precisely the condition imposed on the Land Grants by Congressional intent. The courts must not let BN escape this responsibilty.

> Development of the holding company structure commonly began with the creation by railroad management of a corporation having a minimum of capitalization, few assets, and little or no means of self-support--in effect "shell" companies. Next the shell holding company would issue a proxy statement or prospectus offering an exchange of its shares for stock of the railroad. Acceptance of the exchange offer by railroad shareholders gave the holding company a majority stock interest in the railroad and the ability to control decisions affecting the railroad. However, to effect substantial transfers of assets from the railroad without being liable to derivative suits by railroad stockholders who did not accept the exchange offer, a further step became necessary. The holding company would hold a new corporation, also nominally capitalized and 100% owned by the holding company, and then merge it with the railroad. A condition of the merger forced minority stockholders to exchange their railroad stock for that of the holding company or accept payment for their stock at a price, based on appraisals, set by the holding company's management. This procedure eliminated the minority shareholders and the threat of derivative suits which could arise from the transfer of railroad assets to the holding company at less than fair market value.

ICC Report, at 11.

7. Federal Income Tax Manipulations.

The ICC found that "holding companies have obtained substantial tax savings by taking advantage of the opportunities provided under federal income tax laws, particularly through the use of consolidated income tax returns." "Federal tax reform legislation in 1976 has liberalized the use of investment tax credits by railroads for taxable years beginning in 1977 and ending in 1983." "Since there is no evidence that the holding companies have reinvested these tax savings in the carriers, savings have been employed to finance diversification and other non-carrier activities of the holding companies." The ICC found a need for some action to limit this tax manipulation in order to "assur[e] that the intended benefits to the carriers are realized." ICC Report, 12-17.

8. Holding Companies Strip Assets From Railroads Through "Advances."

A further method of asset transfers from railroads to their holding company parent corporations is the "advance," in the form of loans and unsecured notes, which the ICC traced to other holding companies, in total more than $300 million:

> Prior to the formation of the holding companies, the railroads directly controlled all the cash in their respective groups through their own cash accounts or through their controlled subsidiaries' accounts by ownership of their stock. When the embryonic holding companies formed by the railroads needed cash for their initial funding and subsequent activities, it was advanced from the railroads. Insofar as could be determined, all of the aforementioned cash advances were repaid, usually with interest. However, the repayments were made with dividends drawn from the railroads in excess of holding company dividend pay-outs or with earnings from subsidiaries previously owned by the railroads. In effect, the railroads which passed up assets to the holding companies were repaid with their own funds or income from the assets transferred.
>
> 9. Administrative Expenses Incurred By Holding Companies.
>
> Holding companies of railroads are basically investment companies holding the securities of their subsidiaries. Since they have no source of income from operations, they must rely on dividends from their subsidiaries to cover expenses incurred for such items as salaries, audit fees, servicing stockholder accounts, rents, and miscellaneous expenses unless such costs are directly charged or allocated to the subsidiaries participating in the holding company group.
>
> . . . The allocation of holding company expenses to group members increases each subsidiary's cost of operation. In the railroad's case such reduction of income tends to increase revenue requirements and, consequently, increases freight rates born by the general public.

ICC Report, at 20.

> 10. Dividend Practices.
>
> The dividend practices of the respondent railroad companies exemplify potential conflict of interest situations that exist when there are common directors of companies within a conglomerate group. When voting on dividends, a director who serves both the railroad and the holding company faces a dilemma. Which should have priority--the interests of the railroad or those of the stockholders of the parent company?
>
> 11. Use Of Carrier's Credit.
>
> The management of parent holding companies can control the assets of wholly owned subsidiary companies. The railroads are generally primary subsidiaries of the conglomerate structures in that they provide, in most instances, the bulk of the financial resources of the conglomerate group. The parent companies have the opportunity to trade on the financial base of the railroad as well as their other subsidiaries. This flexibility enables the holding company to use the proceeds of borrowing for its own purposes while pledging certain assets of the railroad.

ICC Report, at 25.

12. Acquisitions and Divestitures.

> In their fiduciary responsibility to stockholders, management of conglomerates would normally be expected to dispose of investments in subsidiary companies, including railroads, when such companies fail to contribute to earnings, growth, or other financial objectives of the holding company.

The ICC found this expectation to be born out in practice.

13. Separation Of Assets.

> The holding company structure has facilitated major removal of valuable non-carrier operating companies and other assets from some of the respondent railroad companies without compensation. Throgh a process of "corporate reorganization" or "restructuring" and subsequent dividends, several of the respondent railroad companies conveyed non-transportation and other assets currently worth billions of dollars to their parent holding companies. Some respondents have stated that these assets--principally land, natural resources, operating companies, and securities--were removed from the railroads in order to foster their profitable development free of regulatory restrictions and with no capital risk to the railroads. However, the loss of these assets has diminished current and potential earnings of the affected railroads and diverted income that was formerly used or available for transportation purposes by the railroads to the holding companies or other non-transportation affiliates. The loss of non-transportation assets also makes the railroad vulnerable to divestiture by the holding company particularly when the transportation activities produce a loss or a marginal rate of return.

14. Burlington Northern's Inability To Form A Holding Company.

In spite of the many dangers to railroads inherent in the holding company reorganization schemes, and Burlington Northern's marginal financial status aside from its non-transportation assets, the Interstate Commerce Commission was not worried about Burlington Northern, for the following reason:

> At present, BN cannot restructure as a holding company because a mortgage indenture restricts transfers of properties from the railroad. Inability to form a holding company, however, has not prevented BN from directly or indirectly developing its natural resources, and the earnings from the development of these natural resources has helped the railroad to sustain its transportation operations.
>
> The example of the Burlington Northern, Inc. tends to refute the argument offered by respondents . . . who maintain that the holding company structure is essential to the profitable development of the illiquid non-transportation assets of the railroad.

ICC Report, at 30.

And, finally, as to the future:

> BN's future prospects are in large measure dependent upon its natural resources, especially coal. The railroad is only marginally profitable standing alone. BN will not be in the position to form a holding company for many years due to indenture restrictions. Under the indenture for Northern Pacific Railway Company prior lien mortgage and land grant 4s, due January 1, 1997, and the general lien gold 3s due January 1, 2047, assumed by the BN, all properties and leaseholds of the railway are subject to lien, and the indentures are not subject to modification nor the bonds to call.

D. The Defendants' Claim To A "Fee Interest Like Any Other Private Party" To The Land Grant Holdings Is Wishful Thinking

The Defendants rely on the litigation in United States v. Northern Pacific Railway Company, 311 U.S. 317 (1940), and on remand, 41 F.Supp. 273 (E.D.Wash. 1941) to support a claim to a fee simple "private party" right. The settlement in that case of certain claims and disputes between the United States government and the railroad did not purport to abolish the limitations on ownership and use inherent in the land grant origin of the railroad's title.

That litigation arose out of a 1929 determination of the President Coolidge Administration that the Northern Pacific Railway Company had failed to live up to its responsibilities under the Land Grant Act in at least twelve particulars:

> 1. That the land grants were made for the purpose of aiding in the construction of the railroad. The total gross receipts of the Northern pacific to June 30, 1917, from the sale of the lands from its grant amounted to $136,118,533.14. The cost of constructing the road did not exceed $70,000,000. The sale of lands has more than paid for the cost of constructing the railroad.
>
> 2. That the Northern Pacific failed to construct 1,507.21 miles of its railroad within the time required by law, thereby rendering the granted lands subject to forfeiture.
>
> 3. That the Northern Pacific failed to dispose of certain of its lands to settlers at not to exceed $2.50 per acre as required by the law. A somewhat similar provision in the Oregon and California grant was held by the Supreme Court to be an enforceable covenant (238 U.S. 393).
>
> 4. That the Northern Pacific failed to dispose of hundreds of thousands of acres of its lands at public sale, as required by law.
>
> 5. That hundreds of thousands of acres of poor land in the Northern Pacific grant were erroneously classified as mineral.

> This land was turned back to the United States and the railroad acquired mineral indemnity rights therefor, which were applied in part on more valuable lands in the indemnity limits.
>
> 6. That under a rule of law laid down by the Supreme Court the Northern Pacific has been erroneously allowed 1,500,000 acres too much land in the State of Washington.
>
> 7. That over 500,000 acres of land credited to the Northern Pacific should be deducted because of conflict with the land grant of another road and the erroneous fixation of the land-grant limit lines.
>
> 8. That approximately 640,000 acres of land have been erroneously allowed the Northern Pacific by reason of the Tacoma overlap.
>
> 9. That the Northern Pacific has received approximately 600,000 acres of land to which they were not entitled under their grant in the Wallula overlap.
>
> 10. That the Northern Pacific has been allowed to make over 1,300,000 acreas of indemnity selections in its second indemnity belt, whereas these selections should have been confined to the first indemnity belt.
>
> 11. That for lands erroneously patented to the Northern Pacific the Government should be entitled to receive at least what the railroad received from the sale of these lands instead of $1.25 per acre.
>
> 12. That the Northern Pacific, under the Mount Rainier Park Act of March 2, 1899, relinquished to the United States thousands of acres of commercially valueless land and received therefor selection privileges applicable to the finest lands they could find in the States of Oregon, Washington, Idaho, Montana, North Dakota, Minnesota, and Wisconsin . . .[5]

The joint congressional committee to investigate these numerous indications of fraud led to an extensive five year investigation and resulted in a Congressional enactment authorizing the Attorney General of the United States to institute litigation "to remove the cloud cast by the Northern Pacific Railway Company on the title of the United States to approximately 7.9 million acres of land . . . located in the indemnity limits of the land grant made to the Northern Pacific." Act of June 25, 1929, 46 Stat. at L 41.

The suit filed by the government asserted legal ownership of the lands being sought by the railroad and charged that the railroad had breached the terms, conditions and covenants of the Land Grant Act and was guilty of fraud in their administration. The government claimed the railroad had no legitimate claims and sought an award of damages for the value of the lands erroneously given to the railway. The railroad asserted an equitable title in the disputed lands and argued that its title had been expropriated by the government. The District Court accepted findings of the Special Master and held the railroad was entitled to compensation for lands which had been withdrawn by the government and to some additional acreage. The government was held to be entitled to compensation for 66,000 acres erroneously given to the railroad. On appeal, the United States Supreme Court remanded with instructions to restore the government charges made against the railroad with regard to the railroad's fraud in breach of the provisions of the land grants. The government had charged that the fraud if established would disentitle the railway to more than a million acres of land for which the lower court had awarded a compensation. Thus the Supreme Court decision insured to the government an opportunity to prove the fraud charges. However, all issues were not decided when, by a quirk of fate, only eight justices sat on the case and could not agree on several key issues. The Supreme Court expressed no opinion on them, taking the unusual step of expressly reserving them for later consideration. These issues included:

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[5] Joint Congressional Committee on the Investigation of the Northern Pacific Land Grants, Hearings, March 18, 1925, at 6-7.

1. Whether the railroad engaged in sham stock sales instead of the bona fide subscriptions required by the Northern Pacific land grant. If genuine subscriptons were not made within two years, the act was, as noted previously, to be automatically null and void.

2. Whether Northern Pacific had ever completed its transcontinental railroad as required by the land grant statute.

3. Whether the railroad had diverted construction funds into the construction of branch lines while the main line stood unfinished.

4. Whether the railroad violated its contract with the United States by failing to open its land grant to settlement and preemption at $2.50 per acre.

> 5. Whether the railroad had violated its contract with the United States by failing to sell lands at public sales upon foreclosure of its mortgage in the 1875 and 1896 reorganization.

311 U.S. at 342.

This left the case in the lower court in an interesting posture. One commentator has noted:

> Northern Pacific could see the handwriting on the wall. It was very unlikely that the corporation could prevail in its efforts to secure additional lands or compensation from the government. In fact, the corporation stood only to lose unless a way could be found out of the lawsuit.

Applegate, "An Unintended Empire: A Case Study Of Rail Land Holdings," cited above, at 157-158. As Professor Ellis has noted:

> The Northern Pacific decided to surrender. No doubt its officers feared the threat of conviction for fraud. Perhaps the prospect of another decade of law suits made them eager to close the books.

Ellis, "The Homestead Clause In Railroad Land Grants," in Ellis, ed., "The Frontier and American Development," Hornell University Press, Ithaca, 1969, at 71.

The railroad thus proposed a settlement whereby all of its claims and the government's claims would be dropped, the fraud and damages charges mooted, and the railroad was to pay a small money judgment to the government. Incredibly, the Attorney General accepted, even though Congress never approved of the settlement. This position prevented the U.S. from obtaining a full and complete accounting of the Northern Pacific land grant violations as directed by Congress. The issues reserved by the Supreme Court were ignored in the settlement.

On August 28, 1941, the proposed settlement was approved by Judge Schwellenbach in Washington's Eastern District Court. United States v. Northern Pacific Railway Co., 41 F. Supp. 273 (E.D. Wash. 1941). The Judge observed that "Congress has not authorized a settlement" (at page 283-284) noted that "This case...has two characteristics which are not usually found in ordinary litigation. In the first place the public interest is involved to a very high degree and, second, the action was started in compliance with an Act of the Congress...." The Judge observed that the government was in a position that "we so often find in cases of litigation where one has a perfectly sound law suit and cannot prove it, and I do not believe it would ever be possible for the government to go back these many years and prove either of the necessary facts in order to recover damages, or what its measure of damages is." 41 F. Supp. at page 283.

What is clear from a careful reading of this case, is that no language or holding in that opinion supports the contention that Defendants hold any land "in fee like any other private party." In addition, the lawsuit involved only the United States and the Northern Pacific Railroad Company. Other interested parties (including shareholders in the railroad) were denied the right to intervene in the litigation, principally because the litigation was begun pursuant to a specific Act of Congress. Indeed, the United States Supreme Court had previously ruled, on the nature of the right-of-way lands, some of which were at issue in United States v. Northern Pacific:

> The substantial consideration inducing the grant was the perpetual use of the land for the legitimate purposes of the railroad....In effect the grant was of a limited fee, made on an implied condition of reverter in the event that the company ceased to use or retain the land for the purpose for which it was granted.

Northern Pacific Railway Company v. Townsend, 190 U.S. 267 (1903) [emphasis added].

Burlington Northern now attempts to argue that the 1941 decision gives its fee simple title to land grant lands "like any other private party." Aside from the obvious argument that this 1941 settlement does not constitute res judicata against the present Plaintiffs, the Plaintiffs believe that this settlement in no way stands for the proposition that Burlington Northern now asserts. Burlington Northern is in no way free to alienate its extensive non-railway land holdings and natural resources base from the railroad in the manner which would substantially undermine the financial capacity to continue its operations. It's one thing to say the railway could sell land for full value in order to apply the proceeds from the sale to construction and operation of the railway. It's another thing entirely, however, to assert that it is the railroad's right (as "fee owners") to spin off, for no value whatsoever, the beneficial control of the land resources into a holding company, whereby the railroad is left to operate bereft of the financial security of its land holdings. If the Act of July 2nd, 1864, means anything, it means that Congress fully intended the railroad to continue its operation secured by the land holdings granted thereunder.

E. Plaintiffs Have Properly Established All Jurisdictional Requirements For Bringing This Lawsuit.

Defendants claim the Plaintiffs lack the necessary jurisdictional bases and justiciable interest in this action. In particular Defendants claim Plaintiffs have failed to allege subject matter jurisdiction, a case and controversy, standing and direct injury. In response, Plaintiffs establish herein that

(1) Federal question jurisdiction is derived from the fact that this action arises under an act of Congress;

(2) The Constitutional case and controversy requirement is met by the provable allegations that Defendants' creation of a holding company is a part of a plan and scheme intended to effect the spin off of the railroad's land and resource assets into the holding company thus causing Plaintiffs immediate economic harm; and

(3) Plaintiffs assert a cognizable legal injury from the plan and scheme the Defendants have already put into effect.

1. This court has subject matter jurisdiction of the law suit since it arises under the laws of the United States.

Article III, Section 2 of the Constitution provides that the federal judicial power shall extend to all cases "arising under" the Constitution, laws or treaties of the United States. The language of the current federal question statute, contained in 28 U.S.C. § 1331(a), as well as § 1337, is strikingly similar to that of the constitutional provisions:

> The District Court shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000 exclusive of interest and costs, and arises under the Constitution, laws or treaties of the United States.

To give rise to federal jurisdiction of a suit arising under the laws of the United States, or any law regulating commerce, the suit must be based on the validity, construction, enforcement or effect of a statute. McGoon v. Northern Pacific, 204 F. 998 (N.D. 1913); Toledo, P. & W. R.R. v. Brotherhood of Railroad Trainmen, 133 F.2d 265, 268 (1943). The claim of the protection of the federal law requiring its construction...makes a federal question. Toledo at page 270.

In Smith v. Kansas City Title and Trust Company, 255 U.S. 180 (1921), a suit had been brought in federal court by a shareholder of a defendant corporation seeking to enjoin the corporation from investing corporate funds in farm loan bonds issued under the authority of the federal Farm Loan Act. Plaintiff argued the investment was illegal and prohibited under Missouri law. The bonds were claimed to be illegal on the grounds that the federal act pursuant to which they were issued violated the United States Constitution. The Court noted

> The general rule is that where it appears from the bill or statement of the plaintiff that the right to relief depends upon the construction or application of the Constitution or laws of the United States, and that such federal claim is not merely colorable, and rests upon a reasonable foundation, the District Court has jurisdiction....(255 U.S. at 199.)

The Court found federal question jurisdiction even though the federal law in question did not create a specific remedy to any private party.

More directly on point, the United States Supreme Court has ruled that a law suit brought by a private party claiming adverse possession to certain lands granted under the July 2nd, 1864, Land Grant Act gave federal question jurisdiction to United States Supreme Court since the suit depends "upon the nature and effect of the acts of Congress." Northern Pacific Railway v. Townsend, 190 U.S. 267, 270 (1903). To the same effect, see Northern Pacific Railway v. Barden, 46 F. 592, 596-597 (D. Mont. 1891), reversed on non-jurisdictional grounds, Barden v. Northen Pacific Railway Company, 154 U.S. 288 (1893).

This action "arises under" the Land Grant Act precisely because the construction and effect of that Act (and case law interpreting it) prevents the Defendant from alienating the land base from the railway operation. Plaintiffs assert herein that the Defendants cannot legally do what they have started to do because they are prevented from doing so by the implied conditions of the Northern Pacific Land Grant Act. Thus clearly the case turns on the construction of this Act.

In an attempt to defeat jurisdiction Defendants argue that the Land Grant Act creates no private remedies which could be sought by a private party, relying on Cort v. Ash, 422 U.S. 66 (1975). Cort v. Ash did nothing to overrule the holding in Smith, supra, that a federal act need not create a specific cause of action in order to provide for federal question jurisdiction. In addition, as Professor Moore has observed:

> The lesson to be taught by Cort v. Ash is that regulatory legislation, like other legislation, is interpreted in light of its language, its evident purpose, and its history, rather than rigid canons of construction.

1 Moore's Federal Practice ¶0.62(2.-2), at 668.

Thus in Cannon v. University of Chicago, 441 U.S. 677 (1979), the Court found a right to pursue a claim despite the absence of any express provision for private litigation in the statute. See also

Sierra Club v. Hodel, 544 F.2d 1036 (9th Cir. 1976); Tunstall v. Brotherhood of Locomotive Firemen, 323 U.S. 210 (1944).

The legislative history of the Land Grant Act outlined above and subsequent judicial interpretation support the view that the Act creates private rights and remedies. The various Plaintiffs herein assert rights and remedies more particular than that of the "general public." They assert rights as owners of railway stocks and bonds, users of railway services, and contractual partners in labor/management relations with the railroad. Thus all have cognizable "special" legal and economic interests in the continued operation/maintenance of the railway in a manner mandated by the Land Grant Act.

In fact, numerous federal cases construing the various railway Land Grand Acts have arisen as private causes of action and remedies.

Thus, in Northern Pacific Railway v. Townsend, supra, a dispute over the right of homesteaders was litigated. The homesteaders, who in later years had entered certain lands granted to the railroad by the 1864 Act, claimed the land under adverse possession. The Court, noting it had federal question jurisdiction, ruled in favor of the railway. Holland v. Northern Pacific Railway, 214 F. 2d 920 (1954), involved a lawsuit brought by Holland, who owned land in Spokane, Washington, which abutted on a strip of land granted to the Northern Pacific Railway Company under the 1864 Land Grant Act. When the railroad attempted to separate its land into a railroad grade and a "Railroad Street" the abutting landowners, including Holland, sued to prevent the creation of a railway obstruction in front of their property in what they contended was a public street. The rather complicated facts of the case turned on an essential interpretation of the 1864 Act. The court held that the right of way lands of the railroad were acquired under the 1864 Act upon the implied condition that they be used for railway purposes, and that the grantee was without the power to defeat the design and purposes of the grant by voluntary alienation of title or abandonment to an adverse claimant, in this case Holland. The court held:

> The power of the railroad company to alienate as well as the power of others to acquire...is measured, not by what can be spared from railroad uses, but by what is required to meet such needs of the public or of individuals as fall within the scope of the principle already discussed."

To similar effect see Barnes v. Southern Pacific Company, 16 F. 2d 100 (9th Cir. 1926) (litigating involving the right of home steaders to claim that the railway abandoned certain land) and Southern Pacific Railroad Company v. Ambler Grain and Milling Company, 57 F. 2d 536 (S.D. Cal. 1932) (prior landowner's right to recover lands subsequently granted to railway under Southern Pacific Land Grant Act).

Finally, Barden v. Northern Pacific Railway Company, supra, was a lawsuit between the railroad and mineral prospectors. The United States Supreme Court held that mineral lands, excluding iron and coal, were excluded from the operation of the land grant whether the lands were known to contain mineral deposits at the time of the grant or not.

In sum, it is clear that the federal jurisdiction exists. The construction of the 1864 Land Grant Act is central to Plaintiffs' claim herein. The judicial history and legislative history of this Act makes clear that rights and remedies for private parties are included within the purview of the Act.

2. The Complaint presents a cognizable case in controversy which the Plaintiffs have standing to litigate.

Defendants have argued that Plaintiffs' Complaint presents no case or controversy justifying a declaratory judgment. They have further alleged that Plaintiffs have suffered no injury and thus have no standing to sue. The crux of their argument is that any injury to Plaintiff is so remote or speculative that the court would be giving an advisory opinion on a hypothetical question rather than adjudicating a present concrete issue between legal adversaries.

The basic test, as stated in Baker v. Carr, is whether the plaintiffs have alleged "such a personal stake in the outcome of the controversy as to assure that concrete adverseness which sharpens the presentation of the issues and upon which the court so largely depends for illumination. . . ."

The rule for the justiciability of a case or controversy has been clearly stated:

> The difference between an abstract question and a 'controversy' contemplated by the Declaratory Judgment Act is necessarily one of degree, and it would be difficult if it would be possible, to fashion a precise test for determining in every case whether there is such a controversy. Basically, the question in each case is whether the facts allege, under all the circumstances, show that there is a substantial controversy between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment.

Maryland Casualty Company v. Pacific Coal and Iron Company, 312 U.S. 270, 273, 61 S. Ct. 510, 85 L. Ed. 826 (1941).

As Professor Moore has noted:

> One purpose of the Act is to permit a party not certain of his rights to avoid the accrual of damages, and to permit an early adjudication of legal relations. The Act is to be liberally construed.

6A Moore's Federal Practice, ¶57.12, at 109.

Thus the Declaratory Judgment Act, 28 U.S.C. § 2201 and Procedure, Rule 57, Federal Rule of Civil Procedure, is designed to adjudicate a real controversy involving parties with adverse legal interests even though the direct injury or damages are threatened and have not yet accrued.

Numerous cases support the proposition that threatened injury presents a justiciable case in controversy. Thus, for example, see Miller v. Kusper, 445 F. 2d 1059 (7th Cir. 1971). Here a justiciable controversy was present between independent candidates and election officials with respect to the former's right to certain voter information registration even though an election had already occurred where there was a likelihood remaining that candidates might seek office again or might as voters wish to support other independents in future elections. In El Paso Building and Construction Trades Council v. El Paso Chapter Associated General Contractors of America, 376 F. 2d 797 (5th Cir. 1967), a declaratory action upheld the validity of restrictive subcontracting clause in a collective bargaining agreement where the declaration of validity would be the first step taken toward the application and enforceability of the agreement. The court ruled that the dispute had taken final shape so that the contested issue of the validity of the clause was clear and there was an actual controversy.

In Parkview Heights Corporation v. City of Blackjack, 467 F.2d 1208 (8th Cir. 1972), a non-profit corporation had acquired land for low and moderate housing projects and had completed architectural and engineering plans. The city in which the project was to be located passed a zoning ordinance prohibiting further multi-family buildings. The court ruled there was a controversy between the corporation and the city despite the failure to allege that the city had prohibited the project, denied a permit, or refused to consider an application for rezoning or amendment of the zoning act.

Murphy v. Kansas City, 347 F. Supp. 837 (W.D. Mo. 1972), an action by owners of land for declaratory relief, challenged the procedure to be employed in a proposed annexation. The court ruled an actual controversy existed between the owners of the land subject to annexation and officials of annexing cities where the ordinance proposing the annexation had been introduced and public hearings had been held although the law itself had not been passed.

Each Plaintiff herein has asserted a cognizable legal interest which would suffer injury if Defendants were able to continue with their plan to transfer non-railroad land assets into the Holding Company. The injury here is not speculative or hypothetical--it is immediate and present. Railway lines are now being retired, hundreds of jobs abolished, substantial assets transferred to the beneficial control of the Holding Company, new corporate structures are being established, and plans are being drafted and implemented to transfer land resources into the Holding Company. All of this is pursuant to a plan which threatens Plaintiffs immediate injury and violation of their legally cognizable rights.

In addition to their economic interests Plaintiffs have standing to assert injury to "aesthetic, conservational and recreational" values as well. See Association of Data Processing Service Organizations v. Camp, 397 U.S. 150, 90 S. Ct. 827, 25 L. Ed. 2d 184 (1970). Sierra Club v. Morton, 405 U.S. 727, 92 S. Ct. 1361, 31 L. Ed. 2d 636 (1972). See also Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 91 S. Ct. 814, 28 L. Ed. 2d 136 (1971) (action brought by persons alleging they were citizens of a city who used a park was entertained).

The Committee to Preserve the Land Grant Railroads represents parties with diverse but legally cognizable interests including public officials of local governments having an interest in the operation and maintenance of rail lines within their jurisdiction, and consumer and railroad user groups having an interest in the financial stability and continued operation of the railroad line. See Exhibit 2, attached. See Sierra Club, supra and Citizens to Preserve Overton Park, Inc., supra; and Hunt v. Washington Apple Advertising Commission, 432 U.S. 333 (1977).

The unions clearly have standing. Certainly the Land Grant Act envisioned that workers would be employed to construct, operate and maintain the rail line and businesses. The creation of the Holding Company and the plan to transfer the non-rail land assets to the Holding Company causes economic and conservational injury to the unions and its membership. The diminished economic stability of the railroad, the collective bargaining partner of the union, are resulting and will result in layoffs, dangerous working conditions, deferred maintenance of rail lines, and threatens financial collapse effecting tens of thousands of workers.

Plaintiffs shareholders and bondholders have a concrete economic interest in the security of their investments and in the continued unity of interest between the railroad they hold bonds and stock in and the land base securing this investment. The mortgage lien instrument specifically establishes, in Article 4, Section 18, that individual bondholders retain legal contractual rights to protect their interests, even though the bond trustees have the obligation to act in their interests in the event of default.

F. Conclusion.

In sum, Plaintiffs' Complaint herein establishes all the necessary jurisdictional basis for instituting and prosecuting this case. All of Defendants' attacks on subject matter jurisdiction, case and controversy, standing and injury are tied up with Defendants' assertion that they do not intend to do what the Plaintiffs assert that they are in fact now doing. This assertion of factual matter into a Motion to Dismiss does not defeat the jurisdiction of this court nor does it provide grounds for the dismissal of this action. Rather than rely on the Defendants' bald factual assertion as to their intentions, this court should deny Defendants' Motion to Dismiss and allow Plaintiffs to prove through discovery the reality and validity of their present factual assertions. If this court were to grant the motion to dismiss, it would be agreeing to Defendants' prayer that this court should "trust them" because they are not doing what Plaintiffs claim they are doing. Determination of this factual issue is precisely the reason why discovery should proceed and this motion should be denied.

IV. BOND INDENTURES.

Burlington Northern argues in Section V of its brief, at pages 20-21, that the rights of bond holders can be protected solely and exclusively by the Trustee, and that bond holders are precluded from taking any legal action to defend their interests, including this one, by Section 17, Article 4, of the Indenture Agreement between Northern Pacific Railway Company and the Mercantile Trust Company, Trustee. It is true that Section 17 reserves to the Trustee the right to pursue certain remedies for default specifically provided in the Indenture Agreement, namely foreclosure of the lien and sale of the security. The pursuit of other remedies, however, in addition to those provided under the Indenture Agreement, such as this action for injunction against illegal transfer of the ownership or control of the land grant properties, is expressly reserved and not precluded by the indenture agreement, as is made explicit in the following section, Section 18, which provides as follows:

> Except as herein expressly provided to the contrary, no remedy herein conferred upon or reserved to the Trustee, or upon or to the holders of bonds hereby secured, is intended to be exclusive of any other remedy, but each and every such remedy shall be cumulative, and shall be in addition to every other remedy given hereunder or now or hereafter existing at law or in equity or by statute.

It is therefore clear that Defendants' sole argument against the bondholder's action is without foundation, in fact, clearly contradicted, by the express language of the Indenture Agreements in question.

V. CONCLUSION.

For the reasons stated above, Defendants' Motion to Dismiss this action should be denied.

DATED: September 28, 1981.

Respectfully submitted,

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March 15, 1982

Hon. Max Baucus
United States Senate
Washington, D.C. 20510

Re: Burlington Northern Holding Company
Senate Committee on Judiciary Hearings of March 26, 1982

Dear Senator Baucus:

Thank you for the invitation to appear and testify at this important proceeding. I am submitting for inclusion in the hearing record the brief we filed in the Federal District Court in Seattle, Washington, in support of our challenge to the Burlington Northern Holding Company strategy, on behalf of the Citizens Committee to Save the Land Grant Railroads, and a number of labor organizations. Since our brief is rather lengthy, I will summarize our position, report to you on the current status of the litigation, and our beliefs as to what the response of Congress ought to be.

The basic theory behind our position is found in two longstanding court decisions. The first was by the Supreme Court of the State of Washington:

> [L]et us keep in mind as we proceed that appellant is not a private business concern, but is a public service transportation corporation;...that appellant cannot abandon its duty to serve the public, nor can it dispose of its property, real or personal, in such a manner as to result in discontinuance of such service; that appellant and its successors in ownership of such property are bound to maintain such service, and incidentally to maintain an organized entity necessarily consisting of equipment and operating property, both real and personal, as a unit organization such as will make the rendering of such service possible.

Northern Pacific v. State, 84 Wash. 510 at 523 (1915). A second precedent is the decision of the United States Supreme Court, holding that:

> Railroads are for many purposes public highways....

> Corporations, it is true, formed for their construction are private corporations, but whilst their directors are required to look to the interests of their stockholders, they must do so in subordination to and in connection with the public interests, which they are equally bound to respect and subserve. All arrangments, therefore, by which directors or stockholders or other persons may acquire gain, by inducing those corporations to disregard their duties to the public are illegal....

Woodstock Iron Company v. Extension Company, 129 U.S. 643, 656 (1889).

Our lawsuit is based on the propositon that Burlington Northern's Holding Company strategy should be declared illegal because it constitutes a clear and present danger to the continued financial viability of essential rail services. As the ICC has reported to Congress:

> Were the railroads receiving these properties, or their railroad successors in interest, to be deprived of the fruits of these land grants, at a time, whether now or in the future, when they are needed to support rail services essential to the public interest, the intention of the Congress in making these grants would be subverted and today's citizens would lose the benefit of the contract made by their forebears with the Land Grant Railroads.--"Railroad Conglomerates and Other Corporate Structures," Feb. 5, 1977, p.74.

Our brief points out over a dozen ways in which the Holding Company strategy threatens the future of the railroad.

The response of the lawyers for the Holding Company to our claims was that they have no obligations to the public, and that even if everything we say is true, we have no right to complain about it. The Holding Company's position is that Northern Pacific did everything it was obligated to do to earn its over 40,000,000 acres of public land when the railroad construction was completed. They feel that if they can earn more profits for their stockholders (largely banks and other large corporations) by non-transportation activities, it is their right to divert the proceeds from the land grants to such activities regardless of the adverse impact on the railroad.

The decision of the Federal District Court Judge was that, even if the Holding Company strategy is violating the intent of Congress, private parties like the plaintiffs in our case shall not be allowed to challenge it in federal court, and that further Congressional action would be required to provide a remedy for such violations as may be occurring.

This presents an urgent necessity for Congressional investigation and action. ICC oversight should not depend on the technical question of whether a few independent switchyards and terminals are actually controlled by the BN system. The disintegration of our national rail transportation system may well become irreversible if rate structures and investment decisions are left in the unreviewable discretion of directors tempted by higher returns in energy or entertainment speculation.

We applaud your initiative in reopening the congressional scrutiny of these thorny problems. Only on the basis of full disclosure by the holding companies, and independent economic analysis by representatives of the public interest, can the Congress structure intelligent and appropriate legislative action.

Sincerely yours,

Daniel Hoyt Smith
Attorney for CSLGR

Senator BAUCUS. Next, we will hear from Pete Pallipamu.

Mr. PALLIPAMU. Senator, thank you very much for inviting us to these hearings. Last May, it appeared as if these hearings may never come true. We particularly appreciate your initiative of bringing us all to these hearings.

My name is Peter Pallipamu, I am local chairman of the Seattle Cascade Lodge 1380 of Brotherhood of Railway and Airline Clerks. I also serve as the chairman of the Railway Intercraft Association, located in Seattle, Wash., and I also work for the Burlington Northern Railroad as a clerk, presently, located in Seattle, Wash.

One of the concerns of the people who are directly interested in the Burlington Northern Railroad's formation of a holding company, the people that I represent, is regarding employment and the direction the railroad is taking since the formation of the holding company. Employment in the railroad industry, especially Burlington Northern Railroad, as a whole is down very seriously. Prior to and perhaps, in anticipation of the Burlington Northern-Frisco Railroad merger in 1980, the BN has experienced severe job cuts. Even so, at the time of merger, BN employment stood over 60,000 employees. Today, it stands little more than 49,000 employees, and there are plans to decrease that figure still further.

These figures do not reflect the employees who are furloughed or who only work a few days per week. "Business Week" reports there has been a 14-percent reduction in employment by BN railroad. It is my belief that the real unemployment at BN is in the neighborhood of 18 to 20 percent. This additional unemployment is a direct result of the holding company's desire to reduce costs under the name of productivity.

The reason I say it is roughly in the neighborhood of 18 percent, if we take the BN's own figures of 49,800 employment at face value, this number includes the employees who may work only 2 or

3 days per month; this figure also includes furloughed employees who are maintained on BN's roles and subject to recall sometime in the future. When we take these factors into consideration, it is my belief that unemployment is in the neighborhood of 18 to 20 percent. But this figure can go even higher if we separate nonunion employees from union employees. Then, unemployment within the unionized employees could go as high as 25 percent. This has never been brought up by the Burlington Northern Railroad.

Another concern of ours is that capital expenditure in the BN Railroad Co. is down in 1981 to $298 million compared to $335 million in 1980, and will decrease further in 1982. This is according to BN's official statement. Hundreds of millions of dollars must be spent to upgrade and maintain Burlington Northern's 29,000 miles of track. Investment in actual railroad operations increased by only 12 percent in 1980, compared to 1979, and decreased by 11 percent compared to 1980. At the same time, investment in subsidiaries of the holding company, such as Forest Products Manufacturing, increased by 93 percent, oil and gas by 380 percent, coal and minerals by 475 percent, and corporate and other operations by 144 percent in 1980. And these are according to the figures supplied by the Burlington Northern Railroad.

Also, the practices of management since the BN-Frisco, especially the holding company, wasted no time in dividing up the resources of the railroad into various subsidiaries. The holding company also wasted no time in reducing its railroad subsidiary employees. This reduction was carried out by offering early retirement to senior officers. Under this plan, a person can be given as much as 180 percent of his annual salary to resign or retire. Some of these officers who resigned are right now working for some Federal agencies. Over 1,050 senior and experienced officers of the railroad were terminated in this manner. This amounted to a severe depletion of experienced and talented managers. This is not only to imply that BN has reduced the number of exempt employees, but replaced them with new and inexperienced employees.

The holding company also plans to transfer anywhere from 50 to 80 top railroad executives from various parts of the country to Seattle to work exclusively for them. This maneuver amounts to a huge brain drain on the railroad, and most of these executives, trained and experienced in railroading, have proved themselves to be top notch and the holding company is offering no compensation to the railroad for their services or their transfer.

Recruitment policies of the holding company show how far railroading is from their minds. Chief executive officer and chairman of the board of the holding company, Richard Bressler, wants to surround himself with people from Arco, his former employer. One of the interesting things that we discovered during our research, which is not complete, is that there seem to be several connections between Arco and its interests and the BN and its coworkers. And when we are finished with our research, we would like to send it to you.

Senator BAUCUS. Thank you very much, Mr. Pallipamu.

[The following was received for the record:]

PETER PALLIPAMU
Local Chairman
Seattle Cascade Lodge 1380
Brotherhood of Railway & Airline Clerks

Chairman
Railway Intercraft Association

POSITION PAPER SUBMITTED TO THE SENATE JUDICIARY COMMITTEE FOR ITS HEARING ON HOLDING COMPANY ON MARCH 21, 1982

My name is Peter Pallipamu, Local Chairman, Seattle Cascade Lodge 1380 of Brotherhood of Railway and Airline Clerks. I also serve as the Chairman of the Railway Intercraft Assn., located in Seattle, Washington. I also work for BN as a clerk, currently, in Seattle, Wash

I appreciate the invitation from the Judiciary Committee. I would especially like to thank Senator Backus for his initiating this hearing.

The collapse of the 6-billion dollar Penn Central railroad empire a few years ago brought down the mightiest of the railroad conglomerates. At that time, there were rumblings on Capital Hill and in the Interstate Commerce Commission to legislate actions of railroad holding companies. Several hearings were held, but no legislation was agreed upon and none materialized. Recently, the deregulation provided in the Staggers Act of 1980 contributed to more abandonments of branch lines by the railroad industry and the creation of more railroad conglomerates. One of the indirect results of this new found freedom was the formation of a holding company by the Burlington Northern Railroad.

It is my view that the energy crunch of the mid-1970s lent impetus to the BN Railroad plans to exploit and develop its energy resources. Accordingly, Richard Bressler, now Chairman of the Board and President of Burlington Northern, Inc. was recruited from ARCO to help develop the energy resources of Burlington Northern Railroad Company. The Interstate Commerce Commission requires railroads to obtain its approval to raise or borrow additional funds, to raise money by issuing securities, to exploit the natural resources such as oil and timber,etc.

The only way for railroads to avoid the scrutiny of the ICC is to form non-transportation holding companies. Therefore, in May, 1981, Richard Bressler in a management recommendation to the stockholders to form such a holding company submitted a prospectus which states: (I quote) "Management believes that the development of the railroad natural resources and non-railroad property could be facilitated if transferred to the holding company or other subsidiaries of the holding company." The prospectus further added: "Holding Company will not assume any of the dept obligations of Railroad as a result of the merger."

On May 14, 1981, stockholders approved the formation of the holding company by only 67.8%, a very low approval rate when reorganization is considered by any company. BN RR holding company follows the textbook pattern of a railroad holding company in its interest to maximize profits to the stockholders rather than secure and preserve the viability of its railroad for the service of the public. This service is what the people of this country intended when they granted millions of acres of land for the use of railroad companies to assure continued service to the public. Over 40 million acres were given as land grants to Northern Pacific Railroad to preserve, operate and maintain a viable transportation system. This is a continuous obligation. Since and shortly prior to forming the holding company plans were made to slash capitall investment, which is the life blood of any corporation and especially capital intensive railroads. These policies created greater Retained Earnings, which are made available in the form of dividends or left as reserve in the Retained Earnings section as surplus cash to be used to invest in non-transportation industries by the holding company.

Employment in the railroad industry as a whole is down very seriously. Prior to and perhaps in anticipation of the Burlington Northern-Frisco Railroad merger in 1980, BN RR had experienced severe job cuts. Even so at the time of merger, BN employment stood over 60,000 employees. Today it stands little more than 49,000 employees and there are plans to decrease that further. These figures do not reflect the employees who are furloughed or who only work a few days per week. BUSINESS WEEK reports there has been a 14% reduction in employment by BN railroad. It is mybelief that the real unemployment at BN is in the neighborhood of 18% or20%. This additional unemployment is a direct result of the holding company's desire to reduce costs, under the name of productivity.

Capital expenditure in the BN Railroad Company is down severly in 1981 to $298-million compared to $335-million in 1980 and will decrease further in 1982. Figures according to BN's Off. Stmt Hundred of million of dollars must be spent to upgrade and maintain Burlington Northern's 29,000 miles of track. Investment in actural railroad operations increased by only 12% in 1980 compared to 1979 and decreased by11% compared to 1980.

At the same time, investment in subsidiaries of the holding company, such as Forest Products Manufacturing increased by 93%, oil and gas by 380%, coal and minerals by 475% and corporate and other operations by 114% in 1980.

It is my intent, hopefully, to show that the BN Holding Company plans to bleed the railroad into poverty while developing its resource subsidiaries. The actions of the holding company might lead a reasonable person to conclude that the BN railroad company intends to go out of business.

QUESTIONABLE AND IMPROPER POLICIES OF THE HOLDING COMPANIES

The Interstate Commerce Commission proposed legislation which was submitted simultaneously to the Senate Committee of Commerce, House Committee on Interstate and Foreign Commerce, and the House Committee on Public Works and Transportation, September 12, 1975. This legislation was intended to amend the Interstate Commerce Act to grant additional authority to the ICC regarding conglomerate holding companies involving carriers subject to ICC jurisdiction.

At that time the ICC provided the following information as to questionable and improper practices of conglomerate holding companies:

1. Carrier's assets were removed through questionable dividend practices.
2. Spinoff of carrier's valuable nontransportation assets.
3. Carriers required to pay special dividends to liquidate holding company loans.
4. Carriers required to pay dividends with highly appreciated assets
5. Carriers required to obtain loan from holding company in order to finance payment of dividends back to holding company resulting in depletion of carrier's retained income and contributing to future cash problems
6. Carrier's assets were removed at less than fair market value resulting in holding company profiting from appreciated value

7. Carrier's assets were removed through payment of management fees, in excess of fair market value, for nonexistent or negligible services

8. Carriers were denied short-term investment opportunities because of holding company restrictions on its use of cash

9. Carriers required to maintain excessive bank balances for holding company credit

10. Carriers required to advance cash to holding company at no interest or at below market interest rates

11. Carrier's costs were increased because of arbitrary billing by holding company of intercompany transactions, such as leases, rental agreements, and improper allocation of expenses

12. Carrier's costs were increased and their cash position weakend because of being required to pay higher Federal Income taxes by holding company tax allocation methods, such as:

    A. Carriers were not given credit for losses of their subsidiaries

    B. Carriers did not receive any benefits from tax losses contributed to a consolidated return

    C. Carrier investment tax credits which produce a lower tax payment for the holding company were not passed down from the holding company

13. Carrier management talent was diverted to noncarrier activities without compensation

These practices are true today as they were in 1975. Nothing has been done to eliminate or minimize these practices. As a matter of fact, the political and economic atmosphere of today provides better opportunity for these improper practices to continue.

RAILROAD-INFLICTED UNEMPLOYMENT

It is a foregone conclusion that the economy of this country is in a deep recession. National unemployment reaches almost 9% to date. This recession is a bonanza for Burlington Northern holding company. Bonanza I say, because the holding company has started to reduce employees under the name of productivity in order to cut costs and increase profits for the stockholders.

According to its own figures, the BN RR had 57,300 employees in December of 1980, although this figure should be 60,000. At that point it began to reduce its employees by various means and the employment figure as of December 1981 is 49,800. This a reduction of roughly 14%. One could take the company's employment figure of 49,800 at face value but this number includes "extra board" employees who may only work two or three days per month. This figure also includes furloughed employees who are maintained on BN rolls and subject to recall sometime in the future. When we take these factors into consideration, it is my belief that unemployment at BN is in the vicinity of 18 to 20%. This figure can go even higher if we separate nonunion from union employees. Then unemployment within the unionized employees could go as high as 25 to 30%. This excessive unemployment goes way beyond the general slump in the economy and is directly attributable to the "reduce at any cost" policy of the BN holding company.

Finally, to further reduce employment the company is intimidating people into being "bought off." In other words, severance pay is paid in return for their resignation from the railroad. Unions representing these employees have negotiated protective benefit agreements in case of layoffs by the company. Playing on the threat of being denied these protective benefits, BN is practicing questionable methods in buying people off. Faced with uncertainty of a job or protective benefits many employees have accepted severance pay which is much less than was agreed upon between the railway unions and the BN railroad. Unions have negotiated away existing benefits in return for these protective benefits. Still further, employees are intimidated into sacrificing more by taking severance pay at less than union and management negotiated for. Some crafts, such as carmen have been almost wiped out by a deliberate program instituted by BN, Inc. In 1980, BN RR had well over 8,000 carmen working to inspect and repair rail cars. Presently, carmen number less than 3,000.

Twenty-five car derailments, such as the one that occurred in Marysville, Washington, where three of these cars contained dangerous chlorine, would not have occurred had there been an inspection by carmen. This craft would have detected water in the journal of these cars which caused this terrible accident. Five thousand people were evacuted for 22 hours. Snohomish County sent a bill for costs to evacuate these people, which BN rejected. It is my understanding that BN paid a $10,000 fine to the Federal Railroad Administration. Two years ago, carmen would have inspected these cars, preventing such disruption and expense. In spite of these derailments, BN RR has embarked upon a program where the repairs to rail cars are ignored unless they can be accomplished on yard trackage. Jobs are abolished, repair facilities, stations and depots closed without any regard as to who will do the work. As a result, derailments are increasing tremendously.

This resultant unemployment, which I referred to in second paragraph of this section, represents anywhere from five to nine percent above the reduction claimed by the railroad. This includes from 3,000 to 5,400 families. Families without income; families who cannot meet their mortgage payments and car payments. Many have resorted to food stamps and other public assistance. This railroad-inflicted unemployment has also brought about dislocation of em ployees. They are told to relocate from communities where they have family roots and thus are reduced to nothing more than economic slaves. Some of these railroad workers have anywhere from 20 to 30 years of devoted service to the BN RR. During this period BN has been making money, unlike the auto industry where billions of dollars are lost. In 1981 BN increased its net income by 22% to $272 million, from $223 million in 1980. There is no justification for this unemployment other than to increase profits and cash flow. While all this is happening, Mr. Bressler goes his merry way buying up other non-transportation and more glamourous businesses.

We have had other recessions in this country. For example, there was a severe recession in the mid-1970s but the railroad was always able to weather these storms. However, this recession beacuse of the policies of the holding company has gone much deeper than the general economic slump. The employees of BN RR are subjected to severe economic insecurities and psychological stress of not knowing if their jobs will be there tomorrow. Likewise, with the holding company's concentration on mainline business, shippers whose businesses are located on branch lines, are subjected to insecurity over whether railroad services will be available to them or not.

Upon the formation of the BN holding company, Richard Grayson, than president of the railroad division, targeted two crafts as being "too many by a lot." These crafts were the clerical and the Maintenance of Way. Maintenance of Way employees maintain the track beds, insert new ties and distribute ballast, etc. These tasks are essential to the safe and efficient operation of any railroad, especially over the long run. These employees along with the carmen havebeen especially hard hit by the formation of the holdingcompany.

Of course the company justifies such cuts in forces as being due to technological innovations which have increased productivity. The only way this so-called productivity has been realized among these crafts is by summarily reducing employees. Take the clerical craft for an example. Few technological changes have been introduced, yet over 3,000 employees have lost their jobs. Anyone can decrease employment when business is down. What happens when the economy takes an upturn? We in the industry know once jobs are taken off, it is next to impossible to put them back on.

EXPLOITATION OF RAILROAD NATURAL RESOURCES SUCH AS COAL, OIL, GAS, AND TIMBER FOR THE EXCLUSIVE BENEFIT OF THE HOLDING COMPANY

Because Burlington Northern's 29,000 miles of track make it the longest American railroad, it is hard to realize that the land and natural resources granted to the company to build and maintain the railroad are now far more valuable than the railroad itself. For example, BN's timberlands are carried in company books at the value of $1 an acre, because of favorable tax treatment of capital gains, but the market value of these lands is approximately $1400 per acre. If BN dropped all of its operations except timber, and its timberlands were fully valued by company accountants and by the stock market, BN stock would be worth $40 per share --- just as much as it now is worth.

Far more important than BN's timberlands are its coal holdings. With reserves of 14.3 billion tons of coal, BN is second only to Conoco among holders of coal in the United States. BN alone could supply all the coal produced in the U.S. for the next twenty years, assuming that the nation continues to produce 600 million to 700 million tons of coal annually, as it did in the 1970's. BN's coal is economically attractive because it is mostly strip-mineable, and 95% of it is the low-sulfur coal used by U.S. utilities.

Since 1970, BN has invested $2.5 billion to transport coal from one area, the Powder River Basin of Southern Montana and Northern Wyoming. BN has two interests in this area; some of its own most exploitable coal deposits are in this area, including the Circle West Mine in Montana. At the same time, it has a century-old monopoly on rail traffic in the Powder River Basin, and related coal-hauling investment absorbed 55% of all funds BN invested in its rail operations between 1976 and 1980. Coal shipments originating in the Powder River Basin now make up about half of BN's annual tonnage ofall commodities it handles across its entire system.

Admittedly, with a commodity like coal, BN does not face a stark choice --- either to develop coal mining, or to transport coal. The activities are obviously interdependent, and rail operations benefit from increased loadings of coal. But a focus on coal and a few other commodities, originating at a few points on the system and shipped in unittrains, is not the same as service to ordinary shippers along BN routes. BN abandoned many branch lines that were not useful for coal operations, at the same time that it was building new track in the Powder River, and merging with the SLSF (which serves many of the midwest and southern utilities that use Powder River coal).

BN's transformation from a railroad company into a natural resources company, began in the 1970's, accelerated in 1981 with the formation of a holding company under a newly elected chairman and chief executive officer, Richard Bressler. Neither Bressler, nor the man Bressler appointed to head the holding compan's railroad unit, Walter Drexel, had previous experience in railroading; both were past executives of ARCO, an oil company which developed significant coal interests in the 1970's. In fact, ARCO itself had grown wildly from a lackluster firm in 1966 to an energy giant in the late 1970's through aggressive acquisition and development of natural resources. In 1966, it merged with Richfield Oil; in 1970, it acquired Sinclair Oil; and in 1977, it purchased Anaconda Co., a major mining firm in one of the largest corporate takeovers of that period.

Even before ARCO executives moved to the helm of BN, the two firms were becoming intertwined geographically, because both companies were focusing on the mineral wealth of Wyoming and Montana as areas for major investment. Anaconda, purchased by ARCO in 1977, had its massive aluminum and copper operations along BN lands and rails in Western Montana --- at Butte, Anaconda, and Copper Falls. Also in 1977, ARCO opened the Black Thunder Mine, its first venture into coal, along BN's tracks in the Powder River Basin of Wyoming. In 1978, ARCO began experimenting with coal gasification in the Powder River, and established a second strip mine in the same area, at Coal Creek. By ARCO's estimates, production at Black Thunder and Coal Creek could make ARCO among the very largest of U.S. coal producers by the mid-1980's.

The fact that BN and ARCO came to view Powder River as the "Saudi Arabia" of U.S. energy wealth in the late 1970's does not mean that these companies saw themselves as competitors in the region. BN does not mine its own coal, but leases reserves to mining companies; conversely, mining companies like ARCO depend on BN for rail transport, and often for leasing privileges.

The interdependence of BN and ARCO's mineral interests since 1977, and the choice of ARCO executives as heads of the holding company and rail operations of BN in 1980 - 1981, raises the question of whether a takeover of BN by ARCO is imminent. The largest blocks of stock in BN are held by major banks; the banks manage this stock on behalf of clients whose identity they do not make public. It is believed that ARCO owns substantial stock in BN through a bank intermediary. Given BN's vast coal holdings, in fact, it would be surprising if ARCO and other oil giants were not interested in acquiring BN. Since 1966, oil companies including Conoco, Occidental Oil, Ashland, Sohio, and Gulf have acquired most of the very largest coal companies. BN's restructuring as a holding company in 1981 would facilitate takeover efforts by an energy firm because the ICC can no longer investigate or publicize any efforts to acquire controlling blocks of BN stock.

Even if the BN is not being taken over by an energy firm, it is now being managed exactly as if it had been. Under Mr. Bressler's leadership, investment in oil and gas producing ventures increased by 380% in 1981 over

1980, and investment in coal and minerals increased by 475% in the same period. During this period, there is simultaneously a marked decrease in investment to the railroad division. These energy-related investments of millions and millions of dollars came from the earnings of the railroad itself. Some of these earnings, due to the capital-intensive nature of the railroad industry, should have been plowed back into the railroad business. However, none of the profits that are derived from the subsidiary companies of the holding company are available for the benefit of the railroad itself. BUSINESS WEEK calls the rail operation a "cash cow" that LN is milking for profits to invest in natural resources. Mr. Bressler has announced a plan to make the non-rail subsidiaries of the holding company together produce as much profit as the railroad subsidiary does by 1990. Presently, 75% of the profit is produced by the railroad.

This goal of making the non-rail operations of BN vastly more profitable by 1990 can be accomplished only by (1) continuing to invest colassally in natural resources for the nextten years and (2) ignoring the investment needs of the rail company during the same period. If money is not spent to upgrade track and equipment, the railroad will continue to have expensive derailments and repairs, which the BN can deduct from its taxes as "costs". Then when the railroad ceases to produce profits, the holding company can justify relinquishing most or all of BN's rail operations. In the meantime, the holding company will obtain its goal of developing oil, natural gas, timber and coal.

MANAGEMENT PRACTICES SINCE THE MERGER OF BN AND SLSF (FRSCO LINE) AND SUBSEQUENT FORMATION OF THE BN HOLDING COMPANY

In December, 1980, the SLSF merged with the BN railroad. In May 1981, BN Inc., a holding company was formed by the approval of the stockholders. The holding company immediately formed many subsidiaries, including Burlington Northern Railroad Company. As of the end of 1981 eight separate subsidiaries exist:

1. Burlington Northern Railroad Company.
2. Meridian Land and Mineral Company - A coal and mineral company.
3. Milestone Petroleum Inc. - An oil and natural gas company.

4. BN Transport Company - A trucking company.
5. Glacier Park Company - A real estate company.
6. BN Timberland Inc. - A forest management company.
7. Burlington Northern Air Freight, Inc.
8. Plum Creek Inc. - A forest product manufacturing company.

The holding company wasted no time in dividing up the resources of the railroad into its various subsidiaries. It intensified investment in these ventures, while investment in the railroad decreased markedly. The holding company also wasted no time in reducing its railroad subsidiary employees. This reduction was carried out by offering early retirement to senior officers. Under this plan a person could be given as much as 180% of his annual salary to resign. Over 1050 senior and experienced officers of the railroad were terminated in this manner. This amounted to a severe depletion of experienced and talented managers. This is not to imply that BN has reduced the number of exempt employees but replaced them with new and inexperienced employees.

The holding company also plans to transer 50 to 80 top railroad executives from various parts of the country to Seattle to work exclusively for them. This maneuver amounts to a huge "brain drain" on the railroad. Most of these executives, trained and experienced in railroading, have proved themselves to be top notch and the holding company is offering no compensation to the railroad for their services or their transfer.

The holding company has introduced a third method to reduce railroad employees in offering severance pay to experienced union personnel. The railroad invested millions of dollars in human resource development in training and developing these talents. The holding company, obsessed with cutting costs, is offering these employees lump sum settlements to get rid of them.

Since the Frisco merger, no one knows who merged with who. There is tremendous dissatisfaction and resentment among the ranks of union employees as well as middle and lower management with the so-called Frisco take-over of BN. This merger has also posed problems as far as the running of the railroad is concerned. Often people wonder how a trainmaster from the Sunbelt can understand the operation of track and rolling stock under the mountainous and inclement conditions which exist in the Pacific Northest.

The Frisco pervasive plantation management practices produce fear often justified minor violations will result in dismissal with no reccurse. Middle and lower management people are told if they do not practice these draconian measures, they will be replaced.

Recruitment policies of the holding company show how far railroading is from their minds. Chief Executive Officer and Chairman of the Board of the holding company, Richard Bressler, wants to surround himself with cronies from ARCO, his former employer. In mid-February 1982, he named Mr. Walter A. Drexel, a former tax accountant at ARCO, as president of BN Railroad Company. What in the world does a tax accountant know about running a railroad? In the March 8, 1982 issue, BUSINESS WEEK reported that Mr. Drexel will eventually go to the holding company in Seattle. On-the-job training for the president of the largest U.S. Railroad? Obviously, he is being trained to serve the holding company and not the railroad.

DETERIORATION OF RAIL SERVICE TO THE PUBLIC

One of the results of the Staggers Act of 1980 is the railroad industry's enhanced ability to abandon supposedly non-profitable branch lines at will and set rates without approval from the ICC. Since its enactment, Burlington Northern abandoned over one thousand miles of branch lines predominantly located in Washington, Montana and North Dakota. There was proposed an actual abandonment of over 2,200 miles branch lines system wide in 1981, according to ST. PAUL PIONEER PRESS/DISPATCH, January 25, 1982. In Washington State alone, BN proposed over 400 miles of branch line abandonments. Service was severely cut in small towns such as Rosalia, Spring Valley, Fairbanks and Mt. Hope. These farmland communities depend heavily on rail services. Due to the absence of rail services these local economies suffer undue hardships.

In some communities, such as Othello and Lynden, Burlington Northern stations were closed down almost over night. Switching and train service is minimal if in existence at all. Instead of developing and helping local communities, BN, through deliberate policies of the holding company, abandons such business as a "bother." Their mottos could be: "Concentrate on main line business. Concentrate on big business. The hell with the little guy."

They seem to forget that it was the little guy, especially the small farmer, who made the railroad what it is today. A Weyerhaeuser lumber operation in Snoqualmie Falls, Washington, is a classic example of how BN is driving away business. This location used to ship 25 to 30 cars of logs a day at the rate of $317 per car. In one hike, BN raised the rate to $622 per car, an increase of 96%. As a result, Weyerhaeuser started shipping by truck.

I can cite other examples where BN deliberately drove away business. In most areas switching service is restricted to two or three days per week. Small shippers who are tired of the "uncaring" attitudes of BN and exorbitant fees resort to shipping through other railroads or choose an alternate mode of transportation.

The policy of the holding company is to concentrate on unit trains containing single commodities such as grain or coal. In many cases the farmers are told to bring their grain to centralized elevators where unit trains originate. Since farmers have no other means to get their product to market they are stuck with whatever arrangements BN dictates.

BN in many cases has charged enormous prices to farmland communities. Montana grain growers have begun a $25-million lawsuit against BN seeking refunds for the higher prices BN allegedly charged them. If nothing is done regarding these tactics either by Congress or by regulatory bodies, similar lawsuits will surface in the near future.

CONCLUSIONS AND RECOMMENDATIONS

History should teach us a lesson from the experience of fallen giants like Penn Central and Illinois Central railroads. The holding companies of these railroads are prosperous and doing rather well, while the railroads themselves went bankrupt. The following are my recommendations to prevent history from repeating itself:

1. One of the main reasons for the formation of holding companies

by railroads is to escape the scrutiny and supervision of the ICC. The transportation network of this country cannot and should not be allowed to depend upon some greedy corporations that have no desire to preserve and guarantee rail service to the public at large. Therefore, it is my opinion that the holding companies that control the railroads should be placed under the jurisdiction of the ICC. The holding companies' financial dealings, such as, acquisition of new and non-transportation concerns, investments in transportation and non-transportation concerns and issuance of securities and borrowing of funds with railroad assets as collateral require regulation.

There should be greater scrutiny and supervision regarding separation of railroad assets and transferring them to holding company subsidiaries. Adequate compensation provisions to railroads should be built in regarding such transfers.

2. Often the public looks askance at the ICC. There is a common belief that it serves the interests of the railroads rather than the general population: Whatever the railroads want, the railroads get. Therefore, every merger approval of the ICC should be carefully examined by Congress. Congress should especially examine the actions of the ICC regarding railroad holding companies.

3. The railroad holding companies are an outgrowth of railroads themselves. All of the resources that go into forming various subsidiaries belong to the railroads. Investments that go into developing and expanding these resources come from the railroads. Presently, there is no adequate compensation made to railroads from the revenues of these subsidiaries.

There must be a provision made to transfer a fair amount of profits from the holding company subsidiaries to the railroad themselves. It is my recommendation that consolidated profits of the holding companies, after a provision is made for a fair return to the stockholders, should be plowed back into the railroads. This will insure, in my opinion, a viable and stable rail transportation system in this country.

4. The ICC should oversee, at periodic intervals, that adequate

investments are made by the holding companies to upgrade and maintain the track beds, rolling stock, etc.

5. In spite of ICC regulation, or lack thereof, of railroad conglomerates, there emerged an attitude on the part of rail management that it owes the public nothing in the way of service. Rail management is quick to forget that an enormous amount of land was granted to the railroads to provide and continue to provide viable, stable and reliable service to the public.

The land grants are not grants to the railroads. Many railroads believe they have fulfilled their obligations once they built the track and carried munitions for the government during time of war at a lower cost. Congress intended to insure, by the 40-million acres of land granted to Northern Pacific Railroad Company (a forerunner of BN railroad) that the railroad would always be able to operate with a healthy economic base, free from threat of bankruptcy, interruption of service and layoffs. The railroads' obligation to the public and their country is not over. Congress intended that this obligation be continuous.

It is my recommendation that there should be legislation that would enable a private party to bring suit in Federal Court if that party believes the railroads violated the above obligation. To my knowledge, there is no such provision in the original land grant charter and if so, this Congress has an obligation to rectify it.

It has been my privilege to testify at this hearing. I appreciate the privilege. Thank you very much.

Senator Baucus. As I understand, you feel that it is your legal opinion that had the BN announced its intention to form a holding company prior to the Frisco merger, that ICC would have had jurisdiction; is that correct, Mr. Smith?

Mr. Smith. That is correct. It was only the prior completion of the merger that made the two systems into one system, and prior to completion of that transaction there were unquestionably two separate systems. The net effect of it was for the holding company to acquire control of two separate carriers, which previously had no connection at all, until the merger was transacted.

Senator Baucus. Thank you both very much. We appreciate your testimony.

At this point, I would like to include in the record a statement by Senator John Stennis, who was unable, unfortunately, to attend the hearing today. I will include his statement immediately following the statement by Senator Melcher of Montana.

Next, we will have a panel of four, which will include John Leuthold, otherwise back home known as "Bud," who is president of the Montana Graingrowers; Paul Sacia, legislative assistant, National Farmers' Union; John LeSeur, attorney, with Slover & Loftus, for the Western Coal Traffic League, and John Creedy, president of the Waterway Transport Association.

I welcome all four of you gentlemen to our hearing, and Bud, why don't you lead off?

STATEMENT OF A PANEL INCLUDING JOHN H. "BUD" LEUTHOLD, JR., PRESIDENT, MONTANA GRAINGROWERS ASSOCIATION; PAUL SACIA, LEGISLATIVE ASSISTANT, NATIONAL FARMERS' UNION; JOHN LESEUR, ATTORNEY, SLOVER & LOFTUS, ON BEHALF OF WESTERN COAL TRAFFIC LEAGUE; AND JOHN A. CREEDY, PRESIDENT, WATERWAY TRANSPORT ASSOCIATION

Mr. Leuthold. Mr. Chairman and staff, I have submitted testimony on behalf of the Montana Wheat Research and Marketing Committee and the Montana Graingrowers' Association. This committee and association represent approximately 10,000 grain farmers in the State of Montana. These associations specialize in the field of marketing, research, and legislative matters.

Senator, I understand you may be catching the same plane that I am today, and I have presented written testimony, which you can read faster than I can read it to you, so I will quickly summarize what we have to say.

Senator Baucus. I do not mean to break your train of thought here, but if any of you, when you are testifying, want to comment on any other preceding testimony, I strongly urge you to do so, because it helps to get a different point of view sometimes.

Mr. Leuthold. I think it is a foregone conclusion that this country and the State of Montana cannot exist without an integrated, nationwide, common carrier system of railroads, and we certainly would not argue for a moment that these railroads should be allowed to make a decent and a fair profit. It also appears to us that the railroads can and do make profits, even when they are subject to governmental regulations.

However, under the merger provisions of the Staggers Rail Act, it appears to us that this country may end up with six or seven giant railroad monopolies in the next few years, handling only bulk commodities, with no competition among themselves or within their system.

It also appears that this process may cause the formation of holding companies. The holding company concept hurts the railroad and its customers, because properties that were either acquired by railroad profits or as a gift or grant are spun off. Naturally, once these properties and assets are spun off into holding companies, they are not going back to the railroad, particularly in times of economic depression. In the case of Montana, the railroad will be coming back to the grain farmers with rate increases, and we are certainly used to those in the State of Montana.

Somewhere down the line, Congress may be faced with the problem of rebuilding the Nation's entire railroad system if railroads are allowed to remove the assets and profits that should be used for the support and maintenance of rail systems.

Another area of concern to Montana shippers is in the area of competitive rail service. You know, a railroad is not like any other company or enterprise, because they have a franchise, which you and I could not practically acquire. Air carriers can be started quite easily, because they do not require rights-of-way or huge capital outlays. If you are a grain farmer in Montana right now, and you do not want to ship your grain on the BN, your only choice is to go by truck. We have learned if you want to have good service and fair rates, you have got to have competition.

In Montana, we are a captive shipper of the Burlington Northern Railroad. It is the only one in town. This is demonstrated very visibly in their rate structure and the fact that they will ship grain out of Nebraska, several hundred miles farther down the road, right through the State of Montana, for the same rates that we pay in the State. And of course, once you get the large regional rail systems, they will maximize their rate levels within their own systems. Rail rates have had a direct effect upon the price that I get for my wheat. Eighty to ninety percent of the grain in Montana goes west, and you either ship it on the BN, or you go on a truck. If railroads decide they want a larger market share, they drop their rates and put their trucks off the road. Trucks help take up the gap, but you can imagine the chaos if they had to ship 170 million bushels of wheat out of the State every year.

Once the railroads own their territory, they are also able to easily abandon branch lines, through rate manipulation and lack of maintenance. Huge railroad systems that are being put together by mergers may be more efficient, but if we are to benefit from it, then perhaps everyone on the large system should be treated equally. Those shippers who presently have access to two or more transportation systems are benefitting from the competition; those who are captive shippers are suffering instead of benefitting from the mergers.

It is not our desire today to harass the railroad or relegislate the Staggers Rail Act, but let me point out that Montana may be a good example to the rest of the Nation if the present trend continues. We are captive shippers of a rail system formed by mergers.

The railroad that serves us has tremendous assets and profits. They have now formed a holding company, splitting these assets. We as Montana shippers pay some of the highest, if not the highest freight rates in the country to get our product to market, and frankly, we have very few alternatives to combat the problem.

Thank you very much for this opportunity.

Senator BAUCUS. Thank you, Bud.

[The following was received for the record:]

TESTIMONY OF

JOHN H. LEUTHOLD, JR.

On Behalf of The

MONTANA WHEAT RESEARCH AND MARKETING COMMITTEE

Great Falls, Montana

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE AND GUESTS. MY NAME IS JOHN H. (BUD) LEUTHOLD AND I AM APPEARING ON BEHALF OF THE MONTANA WHEAT RESEARCH AND MARKETING COMMITTEE, LOCATED IN GREAT FALLS, MT. I APPRECIATE THE OPPORTUNITY TO BE HERE TO TESTIFY ON THESE ISSUES.

THE MONTANA WHEAT RESEARCH & MARKETING COMMITTEE REPRESENTS THE VARIED INTERESTS OF BARLEY AND WHEAT PRODUCERS IN MONTANA. THE COMMITTEE IS CONCERNED WITH BOTH MARKETING AND RESEARCH INVOLVED IN GRAIN PRODUCTION IN MONTANA.

THERE ARE A COUPLE OF POINTS I WOULD LIKE TO MAKE TODAY. I WOULD LIKE TO SET THE TONE ON THE BASIS THAT WE HAVE HAD OVER 100 YEARS OF TRANSPORTATION NETWORK DEVELOPMENT IN THIS COUNTRY, AND YET SOME OF OUR CONCERNS TODAY ARE SIMILAR TO CONCERNS THAT WERE EXPRESSED BY OUR FOREFATHERS OVER 100 YEARS AGO. THERE IS NO WAY THAT ANY GREAT NATION CAN EXIST WITHOUT AN INTEGRATED, NATIONWIDE, COMMON-CARRIER SYSTEM OF RAILROADS. THE MERGER PROVISIONS OF THE STAGGERS RAIL ACT OF 1980 ALLOWED

THE CREATION OF A VERY LIMITED NUMBER OF GIANT RAILROAD SYSTEMS HANDLING PRIMARILY BULK MATERIALS FOR ONLY THE LARGEST SHIPPERS AND THE SYSTEM MAY NOT, IN FACT, MEET THE NEEDS OF THE NATION'S COMMERCE FOR THE BASIC NATIONAL DEFENSE NEEDS.

THE HISTORY OF THE PAST HUNDRED YEARS HAS PROVED THAT PRIVATELY OWNED COMMON-CARRIER SYSTEMS SUBJECT TO REGULATION CAN AND DO EXIST, AND DO, IN FACT, FLOURISH.

THE MONTANA WHEAT RESEARCH & MARKETING COMMITTEE HAS A CONCERN THAT WITH THE STAGGERS RAIL ACT, CONSIDERATION BY THE INTERSTATE COMMERCE COMMISSION OF ASPECTS OF THE HOLDING COMPANIES, RAIL MERGERS AND GENERAL RATE JURISDICTIONS HAVE BEEN SO DIMINISHED THAT THERE IS NOT A PARLANCE OF CONSIDERED THOUGHT FOR INVESTIGATIVE WORK BEING DONE TO MAKE SURE THAT THE PUBLIC INTEREST IS BEING SERVED. ARGUMENTS WERE MADE THAT THE RAILROADS SHOULD BE DEREGULATED BECAUSE THE AIRLINES AND TRUCKS WERE DEREGULATED. THERE IS A GREAT DIFFERENCE BETWEEN DEREGULATION OF A NATURAL COMPETITIVE INDUSTRY AND A NATURAL MONOPOLISTIC INDUSTRY. IN FACT, IF ONE LOOKS AT THE AIRLINE AND THE MOTOR CARRIER DEREGULATION, THE QUESTION IS STILL UNDECIDED AS TO WHETHER THAT WAS A GOOD THING. IT MAY WELL BE THAT TOO MUCH COMPETITION AND PREDITORY PRICING WILL SUFFICIENTLY UNDERMINE THE FINANCIAL STABILITY OF THE AIRLINE INDUSTRY AND DESTROY THEM AS PRIVATELY OWNED COMMON-CARRIER SYSTEMS.

THE RAILROADS ARE MAKING MORE MONEY THAN THEY EVER HAVE, AND ARE DOING SO UNDER A RECESSED ECONOMY. IT IS NOT, HOWEVER, FREE COMPETITION IN A FREE MARKET PLACE THAT HAS PRODUCED SUCH RESULTS FOR THE RAILROADS. IN CONTRAST TO THE AIRLINE AND MOTOR CARRIER INDUSTRIES, THERE HAS NEVER BEEN A FREE COMPETITIVE MARKET SYSTEM IN RAILROAD TRANSPORTATION--AND THERE NEVER WILL BE. ALL OF THE ANTI-TRUST LAWS IN THE WORLD WILL NEVER GUARANTEE A FREE MARKET PLACE IN THE RAILROAD TRANSPORTATION MARKET PLACE. THERE COULD NEVER BE COMPETITION WITHIN THE RAILROAD INDUSTRY WITHOUT THE RIGHT OF FREE ENTRY, AND THERE CAN NEVER BE FREE ENTRY IN THE RAILROAD SYSTEM AS THERE IS IN AIRLINES AND TRUCKS. SHIPPERS LOCATED IN MONTANA ARE CAPTIVE TO THE RAILROAD INSOFAR AS THE RAILROAD IS CONCERNED. IN THE ABSENCE OF GOVERNMENT COMPULSION, A SHIPPER CANNOT REACH ANOTHER RAILROAD WITHOUT THE PERMISSION OF THE RAILROAD ON WHOSE LINE HE IS LOCATED. TODAY THAT IS BEING BROUGHT HOME WITH FORCE TO MANY SHIPPERS WHO A YEAR AGO WOULD NOT HAVE BELIEVED WHAT WAS GOING TO HAPPEN TO THEM.

OUR PURPOSE HERE TODAY IS NOT TO HARANGUE THE RAILROADS OR, IN FACT, TO RELEGISLATE THE STAGGERS RAIL ACT; BUT RATHER TO OFFER THIS COMMITTEE SOME SUGGESTIONS ON STRENGTHENING THE RAILROAD SYSTEM IN THIS COUNTRY AND CONCURRENTLY PROTECT THE PUBLIC INTEREST.

A FEW BASIC ISSUES SHOULD BE COMMENTED ON IN DETERMINING WHETHER HOLDING COMPANIES HELP OR HINDER AGRICULTURE IN OUR STATE. OF PARAMOUNT CONCERN IS THAT A HOLDING COMPANY IS NOT ENGAGED IN TRANSPORTATION AND DOES NOT HAVE DIRECT CONTROL OVER THE PROPERTIES OF THE CARRIER ALTHOUGH

IT OWNS DIRECTLY OR THROUGH SUBSIDIARIES, THE STOCKS OF THAT CARRIER AND STOCKS OF VARIOUS OTHER COMPANIES THAT ARE NOT CARRIERS AND UNRELATED TO TO ALL THESE SEPARATE ENTITIES EXCEPT BY AFFILIATION THROUGH A COMMON PROPRIETOR. WHEN A HOLDING COMPANY'S INVESTMENTS AND INTERESTS ARE WHOLLY UNRELATED TO TRANSPORTATION, AND ITS INTEREST IN THE TRANSPORTATION CARRIER IS SUBORDINATE TO ITS PRIMARY INTEREST IN EITHER PRODUCTION OR SOME OTHER SERVICE OTHER THAN FREIGHT TRANSPORTATION, THEN THERE CAN BE A TENDENCY TOWARD SERVING THE PRIMARY INTERESTS OF THE HOLDING COMPANY AS OPPOSED TO THE SERVICE OF TRANSPORTATION. HOLDING COMPANIES ARE NOT ACCOUNTABLE TO ANY ENTITY GOVERNING TRANSPORTATION AND, THEREFORE, THERE CAN BE A TENDENCY TO USE ASSETS CREATED BY THE TRANSPORTATION SERVICE ITSELF TO ADVANCE THE INTERESTS OF OTHER ENTITIES THAT COULD NOT SURVIVE ON THEIR OWN. WHILE ADVANCES TO NON-CARRIER AFFILIATES, TYPICALLY THE PARENT HOLDING COMPANY, MAY BE TECHNICALLY CHARACTERIZED AS AN ASSET TO THE CARRIER, THE REALITIES OF THE BUSINESS WORLD AND THE SEARCH FOR GREATER RATES OF RETURN IN NON-CARRIER INVESTMENTS INDICATE THAT THE USEAGE OF THIS ASSET IS OFTEN PERMANENTLY LOST TO THE CARRIER. WHAT GOES UP TO THE PARENT COMPANY FREQUENTLY DOES NOT FLOW BACK TO THE CARRIER. IF HOLDING COMPANIES ARE ALLOWED TO BE FORMED WITH THIS TYPE OF ACTIVITY GOING ON, THEN THERE IS NO QUESTION THAT THE FORMATION OF HOLDING COMPANIES WOULD HINDER AGRICULTURAL SHIPPERS, ESPECIALLY IN AREAS WHERE THEY ARE CAPTIVE, SUCH AS MONTANA. AGRICULTURAL PRODUCTS, BASICALLY GRAIN, CONTRIBUTE A HANDSOME SHARE TO THE NET PROFIT OF BURLINGTON NORTHERN. UNDER A HOLDING

COMPANY ARRANGEMENT, THESE FUNDS CAN BE LEGITIMATELY INVESTED ELSEWHERE AND THEN WHEN THE CARRIER REACHES A CONDITION OF ECONOMIC RECESSION, HE TURNS TO CAPTIVE SHIPPERS AND THE PRODUCTS THEY PRODUCE AND REQUIRES THEM TO MAKE AN EVEN GREATER CONTRIBUTION THAN THEY HAVE IN THE PAST. IN MY VIEW, A HOLDING COMPANY THAT OWNS AND CONTROLS THE STOCK OF A TRANSPORTATION ENTITY MUST BE GOVERNED BY THE AGENCY FIXED WITH THE RESPONSIBILITY TO PROTECT THE PUBLIC INTEREST, AND CURRENTLY THAT IS THE INTERSTATE COMMERCE COMMISSION. IF ASSURANCE COULD BE GUARANTEED THAT AGRICULTURAL SHIPPERS, OR SHIPPERS CAPTIVE TO RAIL, HAVE SOMETHING TO GAIN BY ALLOWING THE FORMATION OF A HOLDING COMPANY GOVERNING THE TRANSPORTATION ENTITY FOR WHICH THEY ARE TOTALLY DEPENDENT, THEN PERHAPS OUR POSITION WOULD CHANGE. THERE ARE NO GUARANTEES THAT I AM AWARE OF; NOR AM I CONVINCED AT THIS POINT THAT HOLDING COMPANIES PLACE PRODUCERS OF AGRICULTURAL PRODUCTS IN A BETTER POSITION THAN THEY ARE TODAY AND, THEREFORE, I AM SKEPTICAL THAT THE ALLOWING OF A HOLDING COMPANY TO OWN AND CONTROL THE RAILROAD IN THE STATE OF MONTANA WOULD BE IN THE BEST INTERESTS OF OUR INDUSTRY. OUR CONCERN IS SIMPLY THAT THIS CONGRESS TAKE A STRONGER OVERVIEW OF HOLDING COMPANY REORGANIZATION BECAUSE OF THEIR PROPENSITY FOR ABUSE.

OUR SECOND MAJOR CONCERN DEALS WITH THE AREA OF COMPETITIVE RAIL SERVICE. HISTORY TELLS US THAT IN ANY OF THE TRANSPORTATION INDUSTRIES THE ONLY THING THAT MAINTAINS SERVICE IS COMPETITION. SERVICE COMPETITION IS WHAT HAS BUILT THE GREATEST RAILROAD SYSTEM IN THE WORLD. AS MORE AND MORE CARRIERS MERGE INTO LARGER AND LARGER SYSTEMS, AND THE FACT THAT EACH

MAJOR RAILROAD SYSTEM IS GIVEN THE LEGAL RIGHT TO CONFINE TRAFFIC THAT IT ORIGINATES ON ITS OWN LINES TO ITS OWN LINES, THERE WILL BE NO INCENTIVE TO MAINTAIN OR IMPROVE SERVICE. IT MAY BE THAT THIS COUNTRY MAY BE FACED WITH SIX OR SEVEN GIANT RAILROAD MONOPOLIES WITHIN THE NEXT TEN OR FIFTEEN YEARS. CONGRESS MUST DEAL WITH THIS PROBLEM SOON. WITH ONLY SIX OR SEVEN MAJOR RAILROAD SYSTEMS IN THE COUNTRY, THEY CAN START TO HANDLE NOTHING BUT BULK COMMODITIES AND AS THERE IS NO COMPETITION AMONG THEMSELVES OR WITHIN THEIR SYSTEMS, THEY WILL NOT BE FORCED TO MAINTAIN COMPETITIVE ROUTES.

THE TRAGEDY OF THIS SITUATION IS THAT ONCE THESE LARGE REGIONAL RAIL SYSTEMS ARE COMPLETED, THEY WILL EACH ONE BE ABLE TO MAXIMIZE RATE LEVELS WITHIN THEIR OWN SYSTEMS AND MAY, IN FACT, MOVE AWAY FROM A NATIONAL RAIL SYSTEM THAT WILL SERVE ALL SHIPPERS AT REASONABLE RATES.

NOW, DEALING WITH RAILROADS MORE SPECIFICALLY. IF I WERE TO DESCRIBE THE MAJOR DIFFICULTIES THAT GRAIN FARMERS ENCOUNTER IN DEALING WITH THE BURLINGTON NORTHERN, I WOULD FIRST SAY THAT LITTLE CONTACT IS MADE DIRECTLY BETWEEN THE GRAIN GROWER AND THE RAILROAD ITSELF. THE GENERAL METHOD USED IN MERCHANDISING OUR GRAIN IS TO MAKE DELIVERY TO A LOCAL ELEVATOR WHERE TITLE IS CONVEYED AND THEN SUBSEQUENTLY SHIPPED AND, THEREFORE, THE TRANSPORTATION PHASE OF THE TRANSACTION BECOMES THE RESPONSIBILITY OF THE TITLE HOLDER, NAMELY THE LOCAL GRAIN ELEVATOR OR THE

PARTY TO WHOM HE SELLS THE GRAIN. THIS IS NOT TO SAY, HOWEVER, THAT THE ACTIVITIES OF THE TRANSPORTATION SYSTEM ARE NOT OF VITAL IMPORTANCE TO THE GRAIN GROWER. REGARDLESS OF THE MODE USED IN TRANSPORTING OUR PRODUCTS TO MARKET, THE FACTOR THAT SETS THE PRICE AT A COUNTRY ORIGIN IN MONTANA IS THE PUBLISHED RAIL RATE FROM THAT ORIGIN TO A PACIFIC NORTH COAST TERMINAL. IT FOLLOWS, THEN, THAT THE LOWER THE FREIGHT RATE, THE HIGHER THE WHEAT PRICE IN THE COUNTRY. THE RAIL FREIGHT RATE THEN BECOMES A MOST IMPORTANT FACTOR IN THE TRANSACTION; AND IN DEALING WITH RAILROAD PEOPLE IN THIS AREA, IT IS DIFFICULT FOR GRAIN GROWERS TO UNDERSTAND THE RATIONAL BEHIND RATE LEVELS THAT ARE PUBLISHED ON WHEAT AND BARLEY FROM MONTANA TO THE NORTH COAST WHEN THEY DO EXCEED RATE LEVELS PUBLISHED FROM OTHER AREAS OF THE COUNTRY, LIKE NEBRASKA FOR EXAMPLE, TO THESE SAME PRIMARY MARKETS WHERE MONTANA GRAIN IS SOLD. THE BASIC DIFFERENCE IS THAT OTHER RAILROADS SERVE STATES LIKE NEBRASKA AND RAIL COMPETITION EXISTS THERE, AS OPPOSED TO MONTANA BEING CAPTIVE TO BURLINGTON NORTHERN. CONCURRENTLY, THE RATES ON GRAIN ARE HIGHER AND THE HIGHER THE FREIGHT RATE, THE LOWER THE WHEAT PRICE.

NOW SKETCHING THE CONCERN OF MONTANA GRAIN GROWERS ON SOME OTHER AREAS, SUCH AS RATE FLUCTUATIONS AND THEIR RELATIONSHIP TO THE PROPORTION OF AGRICULTURAL COMMODITIES MOVED BY RAIL VERSUS TRUCK/BARGE. IT IS OBVIOUS THAT FROM PAST PRACTICES, THE RAILROADS WANT A MARKET SHARE SOMEWHERE IN THE 70 TO 90% RANGE. WHEN THE MARKET SHARE BY RAIL DROPS BELOW THAT LEVEL, AN ADJUSTMENT IS MUCH EASIER TO NEGOTIATE BECAUSE THEY HAVE

SEVERAL NET DOLLARS TO GAIN IN MAKING SUCH ADJUSTMENTS. WHEN THE MARKET SHARE IS EQUAL TO 80 TO 90% OR BETTER, REDUCTIONS ARE FEW AND FAR BETWEEN AND INCREASES ARE MORE FREQUENT. NOW THAT WE ARE OPERATING UNDER THE PROVISIONS OF THE STAGGERS RAIL ACT OF 1980, WE SEE QUARTERLY INFLATIONARY INCREASES ON ALL INTERSTATE COMMODITIES AND THEN WHERE THERE IS A COMPETITIVE FACTOR THAT BEGINS TO TAKE AN UNSATISFACTORY SHARE, THESE INCREASES ARE BACKED OFF TO THE ORIGINAL RATE LEVEL THAT APPLIED PRIOR TO THAT INCREASE. THE BOTTOM LINE IS THAT RAIL RATES HAVE A TREMENDOUS INFLUENCE ON THE PRICE OF WHEAT IN THE COUNTRY, AND ALSO CONTROL WHETHER THE GRAIN WOULD MOVE IN RAIL SERVICE OR IN A TRUCK/BARGE COMBINATION THROUGH THE CLEARWATER, SNAKE OR COLUMBIA RIVER SYSTEMS. THE RATE LEVEL CONTROLS COMPETITOR PROFITS AND CAN TOTALLY ELIMINATE THEM IF THE RAILROAD SO DESIRES.

IN CONNECTION WITH RAIL LINE ABANDONMENTS, THE CONCERN OF THE GROWER IS THAT RATE LEVELS ON BRANCH LINES COULD REACH A LEVEL THAT WOULD TOTALLY EMBARGO THE MOVEMENT OF GRAIN BY RAIL. FOR EXAMPLE, SOME BRANCH LINES HAVE SINGLE CAR, 26-CAR AND 52-CAR RATES, HOWEVER, THE CONDITION OF THE LINE IS SUCH THAT FOR SAFETY REASONS, HEAVY LOADINGS AND MULTIPLE CAR UNITS ARE NOT PERMITTED, NOT-WITHSTANDING PROVISIONS PUBLISHED IN THE TARIFF. UNDER THESE CIRCUMSTANCES, SINGLE CAR UNITS ARE THE ONLY METHOD AVAILABLE, AND THE RATES ARE HIGHER THAN THE MULTIPLE CAR UNITS AND, THEREFORE, THE ELEVATOR LOCATED ON THIS BRANCH LINE LOSES HIS POWER TO BUY COM-

PETITIVELY, AND THE GRAIN MOVES FROM THE FARM TO A LARGER TERMINAL THAT CAN TAKE ADVANTAGE OF THE 26 OR 52-CAR RATES. BUYERS USE PORTIONS OF THOSE SAVINGS TO INDUCE THE MOVEMENT OF GRAIN TO A MAIN LINE POINT DIRECT FROM THE FARM. THIS BY-PASSING OF THE BRANCH LINE ELEVATOR CAN BE LIMITED IF THAT ELEVATOR CHOOSES TO TAKE LITTLE OR NO MARGIN, AND THEN IS FORCED TO TRUCK HIS GRAIN TO THE PRIMARY MARKET AT RATES LOWER THAN RAIL SO HE MAY COMPETE WITH THE LARGER TERMINAL IN THE OVERALL TRANSACTION. WITH THIS TYPE OF THING GOING ON, RAIL TRAFFIC FROM BRANCH LINES CONTINEUS TO DETERIORATE AND ULTIMATELY THE RAILROADS ARE IN A POSITION TO SHOW THAT THE LACK OF BUSINESS WILL NOT JUSTIFY THE COST OF MAINTENANCE OR REHABILITATION AND, THEREFORE, THE LINE SHOULD BE ABANDONED. THIS SITUATION AS VIEWED BY A GRAIN GROWER, IS TOTALLY CONTROLLED BY THE RAILROAD ITSELF, AND THOSE FIXED WITH THE RESPONSIBILITY OF GRANTING THOSE ABANDONMENTS SHOULD BE APPRISED OF WHAT IS GOING ON PRIOR TO THE TIME THE RAILROAD ABANDONMENT APPLICATION IS FILED AND EVIDENCE PRESENTED TO MAKE IT LOOK LIKE THE RAILROAD CANNOT CONTINUE TO OPERATE THE LINE BASED ON PAST SHIPPING PATTERNS THAT ARE TOTALLY CONTROLLED BY THE RAILROAD ITSELF.

OUR CONCERN IN MONTANA DEALS WITH THE FACT THAT IT WILL TAKE A GREAT DEAL OF THOUGHT AND COOPERATION AMONG THE RAILROADS AND THE SHIPPING PUBLIC TO ACCOMPLISH PRESERVATION OF THE SYSTEM IN SERVING THE PUBLIC INTEREST. THE MONTANA WHEAT RESEARCH & MARKETING COMMITTEE, TOGETHER WITH GRAIN INTERESTS IN MONTANA, HAVE SOUGHT DIALOGUE WITH THE RAILROADS IN

COOPERATION ON AREAS OF CHIEF CONCERN IN MONTANA. CERTAINLY, THE RAILROADS WILL HAVE TO STOP A LOT OF THEIR PRESENT TACTICS IN ORDER TO BETTER SERVE THE PUBLIC INTEREST, AND NOT SELF-DESTRUCT AS A PRIVATE ENTERPRISE. THE SHIPPERS, OF COURSE, MUST RECOGNIZE LEGITIMATE FINANCIAL NEEDS OF THE CARRIERS, AND WE IN MONTANA DO. HOWEVER, WE MUST ALSO RECOGNIZE THAT THE LONG-TERM FINANCIAL WELL BEING OF THE GENERAL PUBLIC AND SHIPPERS REVOLVES AROUND THE COMMON-CARRIER RAIL SYSTEM, WHICH IS ADEQUATELY SUPERVISED AND HAS A SENSITIVITY TOWARD ALL ASPECTS OF ITS LONG-TERM SURVIVAL. A LOT DEPENDS UPON, OF COURSE, HOW QUICKLY THE RAILROADS, THE SHIPPERS AND THE POLITICIANS CAN COME TO GRIPS WITH THE FACT THAT ONE OF OUR MAJOR OBJECTIVES IS TO PRESERVE RAILROADS IN PRIVATE OWNERSHIP, YET HAVE A RAILROAD SENSITIVE TO THE PUBLIC NEED.

THANK YOU

Senator BAUCUS. Next, we will hear from Paul Sacia.

Mr. SACIA. Thank you, Mr. Chairman.

I am Paul Sacia, legislative assistant to the National Farmers' Union, and we want to thank you for conducting this hearing today.

The Farmers' Union, as well as well as most of the other major farm organizations in this country, has called for a congressional inquiry into the transfer of land grant resources from railroad companies into the giant holding companies which they have formed. And for your information, I have attached some letters, statements and resolutions for your own perusal, by other farm organizations on this issue.

Because transportation of our members' commodities and the items required for their production are so major to the cost of the farming operation, rail rates and branchline abandonments are vital concerns of ours. Therefore, we are especially disturbed over the rail industry's handling of its vast natural resources, particularly their land grant holdings, and the ever-present threat of abandonment of many branchlines by railroads claiming unprofitable operations.

As you know, Mr. Chairman, more than 100 years ago, between 1850 and 1871, substantial grants of public lands were made to railroad builders in the West, Midwest, and South to support the construction of the national railroad system. The grants were extensive, consisting of 128 million acres of Federal land, 49 million acres of State lands, for a total of 177 million acres. They comprise one-tenth of the entire land mass of the continental United States, and up to 30 percent of the area of individual major States. I have listed here those States that are involved and the percentage of land grant land within those States.

Many of these States, Mr. Chairman, are where our farmers are having their most serious transportation problems. Wildly fluctuating rail rates and increased branchline abandonments threaten the efficient flow of our members' commodities—a fact that is even more important in light of the current depressed farm economy.

The four major western railroads, the Burlington Northern, the Union Pacific, the Southern Pacific and the Santa Fe, received 88 percent of all Federal land grants. These properties are rich in oil, coal, timber and other resources, and together with reserve mineral rights on grant lands previously sold, produce a large and rapidly rising flow of cash income.

Although the lands were clearly granted for railroad purposes, three of these major railroad systems, the Union Pacific, the Santa Fe, and the Southern Pacific, have transferred the lands to holding companies of affiliates that have no responsibility for railroad service. The fourth system, the Burlington Northern, has only just established a holding company, and similar transfers of the land originally granted can be expected within the near future.

These holding companies were established in order to separate land and mineral wealth from their railroad responsibilities.

When Congress passed the Railroad Revitalization and Regulatory Reform Act of 1976, they included a proviso, section 903, which required the Interstate Commerce Commission to report back to Congress about any concerns they might have in regard to railroad conglomerates. The ICC did report back and express some concerns, like this, and I quote:

> We are particularly concerned that lands which were granted by the Federal government to railroads to enable them to fund the construction and operation of their lines * * * have been and will be transferred from the railroads to their parent holding companies at less than fair value. Were the railroads receiving these properties * * * to be derived of the fruits of these land grants at a time * * * when they are needed to support rail service essential to the public interest, the intention of the Congress in making these grants would be subverted, and today's citizens would lose the benefit of the contract made by their forebearers with the land grant railroads.

We are constantly being subjected to complaints by the railroads about high costs and the unprofitability in providing a public service. Further, we are continually threatened by additional rail abandonments, which seriously erode a vital transportation network.

However, at the same time we must note that, first, the Burlington Northern has over 60 billion tons of coal reserves, far exceeding any coal company in the United States; second, Union Pacific owns the world's largest deposits of trona, from which soda ash, a major industrial chemical, is derived; third, there are literally billions of dollars in additional oil, gas and timber resources owned by the land grant railroad holding companies; and fourth, we are always hearing words such as those coming from the President of the Southern Pacific when he said that the Union Pacific land grant assets constitute "unbelievable riches".

With near total rate freedom granted by the Staggers Act of 1980, the planned railroad mergers creating regional monopolies in different sections of our country, the 1981 Tax Act allowing railroads to write off billions of dollars in past track investment, and now with the pending waterway user charges placed on their barge competitors and being pushed by this administration, Congress must insist that these "unbelievable riches" be used to provide an efficient and economical rail transportation system. There has never been a public accounting of the value of these assets nor of the abundant and rapidly rising income that they produce. Such an accounting is needed to help resolve the controversy over the amounts of Government subsidy which have benefited the railroads in comparison with the help received by competing transportation modes.

We want to make it clear, Mr. Chairman, that the NFU has no interest in the Federal Government reclaiming these railroad land grants, only that these assets that the railroads have received be used for the purpose intended. We feel that a congressional investigation is necessary for five basic reasons: First, to determine what, if any, continuing obligation land grant railroads have in maintaining and operating lines constructed under the terms of the land grant agreements; second, to establish a national policy of diversion of land grant assets from the railroad operating companies; third, to determine the value of land grant assets held by the railroads, as well as the current income being derived from such assets; fourth, to determine the extent to which the ICC should permit rail services to be abandoned in light of Government provided land grant assets; and last, to determine if rail rates have been artificially high because profits from land grant assets have not been considered in setting rail rates.

Thank you for your consideration.

Senator BAUCUS. Thank you, Paul. Could you for the record provide this committee with the list of the farm organizations which also want an investigation of the land grant question?

Mr. SACIA. Yes, I will be glad to do that.

[The following was received for the record:]

National
Farmers Union

STATEMENT OF

PAUL R. SACIA
LEGISLATIVE ASSISTANT
NATIONAL FARMERS UNION

BEFORE THE

SENATE JUDICIARY COMMITTEE
UNITED STATES SENATE

CONCERNING
RAILROAD LAND GRANTS

WASHINGTON, D.C.
MARCH 26, 1982

Mr. Chairman and members of the Committee:

I am Paul R. Sacia, Legislative Assistant for the National Farmers Union, an organization of 325,000 family-scale farmers in the major producing areas of the nation. The Farmers Union, as well as virtually every farm organization in the United States, has called for a Congressional inquiry into the transfer of land grant resources from the railroad companies into the giant holding companies formed by railroads. For your information, I have attached some of the many letters, resolutions and statements that have been made by farm groups over the past several months on the issue.

Because transportation of our members' commodities and the items required for their production are so major to the cost of the farming operation, rail rates and branchline abandonments are vital concerns of ours. Therefore, we are especially disturbed over the rail industry's handling of its vast natural resources, particularly their land grant holdings, and the ever-present threat of abandonment of many branchlines by railroads claiming unprofitable operations.

As you know, Mr. Chairman, more than a hundred years ago, between 1850 and 1871, substantial grants of public lands were made to railroad builders in the West, Midwest, and South to support the construction and operation of a national railroad system. The grants were extensive, consisting of 128 million acres of Federal land, and 49 million acres of state lands, for a total of 177 million acres. They comprise one tenth of the entire land area of the Continental United States, and up to 30% of the area of individual major states.

32% of all land in Florida
24% of all land in Minnesota & North Dakota
22% of all land in Washington
20% of all land in Texas
16% of all land in Montana, Kansas & Nebraska, the very heart of the U.S. wheat-producing region
15% of all land in Iowa
13% of all land in Michigan
12% of all land in California
11% of all land in Arizona and Wisconsin
10% of all land in Wyoming

Many of these same states, Mr. Chairman, are where our farmer members are having their most serious transportation problems. Wildly fluctuating rail rates and increased branchline abandonments threaten the efficient flow of our members' commodities--a fact that is even more important in light of the current depressed farm economy.

The four major Western railroads, the Burlington Northern, the Union Pacific, the Southern Pacific and the Santa Fe received 88% of all federal land grants.

Substantial acreages of these lands are still retained by the railroads or their affiliates. These properties are rich in oil, coal, timber and other resources and, together with reserve mineral rights on grant lands previously sold, produce a large and rapidly rising flow of cash income.

Most of these land grants were subject to a provision excluding mineral bearing lands. However, lands containing coal and iron reserves were exempted from this exclusion, proving to be extremely beneficial to these 4 major western railroads because of the enormous coal reserves on grant lands.

Several million acres of grant lands are still retained today and mineral rights are owned on several million acres more. Although the lands were clearly granted for railroad purposes, three of these major railroad systems, the Union Pacific, Santa Fe and Southern Pacific have transferred the lands to holding companies of affiliates that have no responsibility for railroad service. The 4th system, the Burlington Northern, has only just established a holding company and similar transfers of the lands originally granted can be expected in the near future. These holding companies were established in order to separate land and mineral wealth from their railroad responsibilities.

When Congress passed the Railroad Revitalization and Regulatory Reform Act of 1976, they included a proviso, Section 903, which required the Interstate Commerce Commission to report back to Congress on the danger of railroad conglomerates. The ICC was very concerned and they emphasized in their report to Congress on railroad conglomerates:

> "We are particularly concerned that lands which were granted by the Federal Government to railroads to enable them to fund the construction and operation of their rail lines...have been and will be transferred from the railroads to their parent holding companies at less than fair value. Were the railroads receiving these properties...to be derived of the fruits of these land grants at a time...when they are needed to support

> rail service essential to the public interest, the intention of the Congress in making these grants would be subverted, and today's citizens would lose the benefit of the contract made by their forebears with the land-grant railroads."

We are constantly subjected to complaints by the railroads about high costs and the unprofitability in providing a public service. Further, we are continually threatened by additional rail abandonments, which seriously erode a vital transportation network.

However, at the same time we must note that:

- The Burlington Northern has over 60 billion tons of coal reserves, far exceeding any coal company in the U.S.
- Union Pacific owns the world's largest deposits of trona, from which soda ash, a major industrial chemical, is derived.
- There are literally billions of dollars in additional oil, gas and timber resources owned by the land grant railroad holding companies.
- In the words of the President of Southern Pacific, the Union Pacific land grant assets constitute "unbelievable riches."

With near total rate freedom granted by the Staggers Act of 1980; the planned railroad mergers creating regional monopolies; the 1981 Tax Act allowing railroads to write off billions of dollars in past track investment; and now with the pending waterway user charges placed on their barge competitors, Congress must insist that these "unbelievable riches" be used to provide an efficient and economical rail transportation system. There has never been a public accounting of the value of these assets nor of the abundant and rapidly rising income they produce. Such an accounting is needed to help resolve the controversy over the amounts of government subsidy which have benefited the railroads in comparison with the help received by competing transportation modes.

We want to make it clear, Mr. Chairman, that the NFU has no interest in the Federal Government reclaiming the railroad land grants, we only wish to insure that those assets received by the railroads from the Federal Government be used for the purpose intended--to provide service for the people.

for 5 [illegible] [illegible]

We feel that a Congressional investigation is necessary to:

- Determine what, if any, continuing obligation land grant railroads have in maintaining and operating lines constructed under the terms of the land grant agreements;
- Establish a national policy of deversion of land grant assets from the railroad operating companies;

- Determine the value of land grant assets held by the railroads as well as the current income derived from such assets;
- Determine the extent to which the Interstate Commerce Commission should permit rail services to be abandoned in light of government provided land grant assets; and
- Determine if rail rates have been artificially high because profits from land grant assets have not been considered in setting rail rates.

Mr. Chairman, I thank the entire Committee for its consideration.

National
Farmers Union

M E M O R A N D U M

November 24, 1981

TO: Members of the Senate Commerce Committee

FROM: Paul R. Sacia, Legislative Assistant

RE: Railroad Land Grant Issue

The National Farmers Union is deeply distressed by the actions of several railroad companies in diverting profits accrued from land grant mineral resources away from railroading responsibilities and to their respective holding companies.

In the late 1800's, the U.S. Government provided 128 million acres of federal land grants and 49 million acres of state land grants, representing nearly 10 percent of the total land mass of the United States, so as to build an extensive transcontinental rail system. It is abundantly clear that while the railroads were given this land to use in a most specific way, they now wish to rid themselves of many of their rail concerns.

Railroad abandonments have become a stark reality for many of this country's farmers, often times leaving them without any rail service or as captive shippers. We believe this most untimely phenomenon is largely inexcusable considering the vast abundance of resources at the disposal of the four major western railroads; the Burlington Northern, Union Pacific, Southern Pacific and Santa Fe.

The four companies have established giant holding companies in order to separate land and mineral wealth from their railroad responsibilities.

While we continually hear from the railroads about high costs and the unprofitability in providing a public service, we must transcend such rhetoric and seek to learn of the railroads' true commitment to holding up their end of the "land grant" bargain.

While the country faces additional rail abandonments, seriously eroding a vital transportation network, it is ironic to note how individual railroads are presently benefitting from land grant holdings.

- The Burlington Northern has over 60 billion tons of coal reserves, far exceeding any coal company in the U.S.
- Union Pacific owns the world's largest deposits of trona, from which soda ash, a major industrial chemical, is derived.

Suite 600, 1012 14th Street, N.W., Washington, D.C. 20005 – Phone (202) 628-9774

- Ben Biaggini, the president of Southern Pacific, testified in the U.P. - Mopac merger case that the U.P. land grant assets constituted "unbelieveable riches."
- The total value of the aforementioned resources plus the oil, gas, timber and other assets is many billions of dollars.

The Federal Government has been far to lax in representing the "public interest" on concerns of corporate responsibility towards the use of such abundant resources.

The National Farmers Union firmly believes that a Congressional investigation into the land grant issue is a positive step towards appropriate federal government involvement. A Congressional inquiry would aid in:

- determining the extent to which the ICC should permit rail services to be abandoned in light of government provided land grant assets.
- determining the value of land grant assets held by the railroads, as well as the current income derived from such assets.
- establishing a policy on diversions of land grant assets from the railroads.
- determining if rail rates have been articially high because profits from land grant assets have not been considered in setting rates.

Today, our nation cannot move its food efficiently and we lack the ability to be a reliable exporter of food and fiber because of the state of our transportation system. Railroads, for much of the country, are the most efficient way to move heavy commodities such as grain. It would certainly be regretable to allow the demise of an adequate rail service system because we failed to understand all the underlying causes.

Any assistance you might provide in arranging a Congressional investigation on the "land grant" issue would be greatly appreciated.

Thank you for your consideration.

A Healthy Agriculture,
A Prosperous
Country . . .
To This End We
Are Sincerely
Dedicated!

National
FARMERS ORGANIZATION

NATIONAL HEADQUARTERS • CORNING, IOWA 50841 • 515/322-3131
Washington Office: Suite 2250 - 475 L'Enfant Plaza
Washington, D.C. 20024 202-484-7075

OFFICERS
PRESIDENT
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VICE-PRESIDENT
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SECRETARY
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Williamsburg, Iowa
TREASURER
[illegible]
Corning, Iowa

December 23, 1981

The Honorable Bob Packwood, Chairman
Committee on Commerce, Science and
Transportation
United States Senate
Washington, DC 20510

Dear Senator Packwood:

The National Farmers Organization is vitally concerned with the issue of transportation for our members. Railroad transportation is essential to our grain, livestock and dairy producers, as well as producers of other farm commodities. We rely heavily on rail, barge and truck transportation to get our goods to export and domestic markets.

We are especially disturbed by the rail industry's handling of its land grant resources, and the ever-present threat of abandonment of many branch lines by railroads claiming 'unprofitable operations'. In fact, these lines appear unprofitable only because they have been separated from the original land grants given to the railroads to encourage and assist in railroad construction and operation.

As a result of recent legislation, the railroads can no longer claim 'inadequacy of income'. The 1981 Economic Recovery Tax Act provides for dramatic increases in railroad profits. It also gives the railroads the right to start writing off about $8 billion in rail track investment, some of which has been carried on the books since 1887. Business Week has already labeled this track depreciation provision as a bonanza for railroads. We at the National Farmers Organization believe that if the railroads are allowed to write off investments going back nearly 100 years, that these tax savings should be utilized to improve service and reduce abandonments.

Further, the Staggers Rail Act of 1980 permits the railroads to justify high rate levels, which have already improved the profit structure by huge proportions.

We believe that the railroads are obligated to continue the operation of branch lines and to provide more economical and dependable service at more reasonable rates for agriculture. At our National Convention on December 1, 2 and 3 in Indianapolis, Indiana, our members spent a great deal of time at meetings and seminars discussing these concerns. We believe that your Committee should look very closely at the questions of the impact of the Staggers Act on farmers and the potential impact of waterway user fees on farmers.

We also feel it is time for your Committee to hold hearings on railroad organization and the rail industry's handling of its vast natural resources. We urge particular attention to the central issue of the land grant railroads' obligation to use their land grant income to sustain and strengthen rail operations, and the extent to which the carriers have breached their contracts with the government by transferring land grant assets to other commercial entities without adequate compensation.

Sincerely,

Charles L. Frazier

Charles L. Frazier
Director
Washington Office

National Council of Farmer Cooperatives
1800 MASSACHUSETTS AVENUE, N.W. • WASHINGTON, D.C. 20036 • TELEPHONE (202) 659-1525

November 17, 1981

Honorable Bob Packwood, Chairman
Senate Committee on Commerce,
Science & Transportation
5202 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Packwood:

The National Council of Farmer Cooperatives, like many other members of the agricultural community, is very concerned about rural America's dwindling access to dependable railroad service at affordable rates. We discussed our concerns with your committee and its staff at considerable length during development of the Staggers Rail Act of 1980, and we greatly appreciate your understanding of our problems and your efforts to minimize the adverse impact of that law on agricultural shippers.

One issue not considered during passage of the Staggers Act was the rail industry's handling of its vast natural resource holdings. Much of these holdings are on land granted to the railroads as an inducement to build lines and provide service to more remote areas of the country. Now the carriers have created conglomerate structures to separate the land holdings from the rail operation. As the land holdings generate considerable income, this permits the railroads to justify high rate levels under the profit-motivated provisions of the Staggers Act.

We believe it is time for your committee to hold hearings on railroad organization and the handling of the land grant resources. We urge particular attention to the issues of the obligation of the land grant railroads to use their land grant income to sustain and strengthen rail operations and the extent to which the carriers have breached their contracts with the government by transferring land grant assets out of the railroad without adequate compensation.

Sincerely,

Donald A. Frederick

Donald A. Frederick
Assistant General Counsel

DAF:jf

national grange

1616 H STREET, N.W. WASHINGTON, D.C. 20006 (202) 628-3507

Edward Andersen, Master

December 1, 1981

Honorable Bob Packwood, Chairman
Senate Committee on Commerce, Science and Transportation
5202 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Packwood:

The National Grange, like other key members of the agricultural community, is very concerned about rural America's dwindling access to dependable railroad service at affordable rates. This is not a new issue for the Grange. In fact, the bitter struggle of the 1860's between farmers and the railroads spurred the founding of the Grange and the creation of the Grange laws. Grange efforts led to the establishment of the Interstate Commerce Commission to oversee the activities of the nation's railroads. Now, implementation of the Staggers Rail Act has refocused rural America's interest in railroad transportation.

One issue not considered during passage of the railroad deregulation legislation last year is the rail industry's management of its vast natural resource holdings. Many of these holdings are on land granted to the railroads as an inducement to build lines and provide service to remote areas of the country. Now, the carriers have used conglomerate structures to separate the land containing the resources from the rail operations. As the land holdings generate considerable income, this permits the railroads to justify high rate levels under the profit-motivated provisions of the Staggers Act. In many instances, removing the profits generated from the land grants from the rail operations has permitted the railroads to close branch lines in agricultural areas by claiming "inadequacy of income."

The delegates to the National Grange's 115th Annual Meeting held in Spokane, Washington, in November of 1981, adopted the following policy statement on railroad transportation:

> Railroad transportation is essential to the nation, having the power of economic life or death in many rural communities. Agriculture is faced with abandonment of many branch lines by certain railroads who are crying "unprofitable operations," yet these lines appear unprofitable only because they have been separated from the original land grants given to the railroads as an inducement for construction and operation. The land grants are, for the most part, still valuable and profitable, and we believe the railroads should retain their original obligation to continue the operation of these branch lines.

We believe it is time for your committee to conduct hearings on railroad organization and the handling of the land grant resources. We urge particular attention to the central issue of the land grant railroads' obligation to use their land grant income to sustain and strengthen rail operations. The extent to which the carriers have breached their contracts with the government and the people by transferring land grant assets out of the railroad without adequate compensation should also be examined. Adequate compensation in many areas would be the continuation of rail service to remote areas at reasonable rates. A growing trend toward abandonment of railroad lines could have serious economic repercussions, and must be conscientiously addressed.

The National Grange appreciates the opportunity to comment on this issue important to agriculture and rural America, and we respectfully request the inclusion of our remarks in the hearing record of November 10, 1981.

Sincerely yours,

Edward Andersen, Master
The National Grange

cc: Senator Howard Cannon

bcc: Don Frederick, National Council of Farmer Co-ops
Ron Schrader
Paul Mills, Office of Transportation, USDA
Rep. Pat Williams

AS AMENDED

A RESOLUTION ADOPTED BY THE
FIVE-STATE LEGISLATIVE CONFERENCE
RAPID CITY, SOUTH DAKOTA, SEPTEMBER 27-29, 1981

RESOLUTION

WHEREAS, certain United States railroads received a total of 128,000,000 acres of federal land to encourage and assist in railroad construction; and

WHEREAS, the total land grants enjoyed by the railroad displace 9.3 percent of the total land area of the United States, exclusive of Alaska and Hawaii; and

WHEREAS, the railroads receiving these land grants built about 18,000 miles of roadway, approximately eight percent of the total railroad mileage of the country; and

WHEREAS, four major western railroads, the Burlington Northern (through the Northern Pacific), the Union Pacific, the Southern Pacific, and the Sante Fe received 88 percent of the 128,000,000 acres; and

WHEREAS, the land grant railroads have retained ownership of some land and much of the mineral rights obtained through said land grants; and

WHEREAS, said land and mineral rights are extremely valuable and they contain farmland, coal, oil, gas, timber, and other resources; and

WHEREAS, the land grant railroads derive significant income from such land and mineral rights; and

WHEREAS, the land grant railroads have also formed holding companies to separate the land, mineral, and natural resource assets from their railroad operations; and

WHEREAS, the railroads (particularly Burlington Northern) have announced intentions to abandon a significant portion of branch line networks in the next few years; and

WHEREAS, rail transportation is vitally necessary to rural states to gather and ship bulk agricultural and other commodities; and

WHEREAS, the abandonment of branch lines will result in a shift in fiscal responsibilities from the private sector to the public sector to maintain a road and highway system;

NOW, THEREFORE, BE IT RESOLVED that the Five-State Legislative Conference and the respective state legislative branches of government in the five member states develop a cooperative effort to influence the retention of a sound railroad network by the land grant railroads and an efficient and economical operation of this system and the benefit of the citizens of those states; and

BE IT FURTHER RESOLVED that the Five-State Legislative Conference request that the United States Congress institute an investigation to accomplish the following:

- Determine the value of the remaining land grant assets currently held by the railroads.
- Determine the current income from land grant assets.
- Determine the extent to which railroads require support of income from land grant assets to maintain and improve services, now and in the future.
- Determine extent to which the Interstate Commerce Commission should permit necessary rail services to be abandoned in the light of government-provided land grant assets.
- Establish a policy on diversion of land grant assets from "railroad" purposess.
- Establish a policy that government-provided land grant assets and income from such assets should be included in the Interstate Commerce Commission determination of adequacy of revenues and earnings of the land grant railroads.
- Examine the extent to which land grant assets and income should be used to replace government subsidy of necessary connecting services to land grant railroads; and

BE IT FURTHER RESOLVED that a copy of this resolution be sent to each member of the Congressional Delegation of the member states of the Five-State Legislative Conference and to the heads of the appropriate federal agencies.

Senator BAUCUS. Next, John LeSeur.

Mr. LESEUR. Mr. Chairman, thank you for extending an invitation to the Western Coal Traffic League to appear and participate in today's hearing. I am an attorney with the law firm of Slover & Loftus, and our firm acts as counsel to the League.

I believe I can summarize my prepared testimony in approximately 3 minutes.

By way of background, the Coal League is comprised of utilities and industries that purchase and receive coals mined west of the Mississippi River. League members received over 20 million tons of coal last year and paid over $350 million in rail freight charges. All members of the Coal League receive their coal by rail, and much of this tonnage is transported over the lines of the Burlington Northern Railroad Co.

My testimony today will focus on the holding company issue. The league's principal and overriding concern with regard to the holding company is that the BN will use the newly formed holding company to strip the railroad subsidiary of valuable assets, including the railroad's substantial profits from its coal-hauling operations and the railroad's valuable land grant property.

We base our concern on two separate, but highly interrelated factors. First, it has been reported in the business press that the holding company is attempting to build up a billion dollar war chest for the purposes of accomplishing a major Marathon Oil-type corporate takeover. Second, both the BN's proxy statement accompanying the holding company formation and other published reports say that a principal source of funding for the holding company's activities will be the railroad. For example, a recent article in Business Week refers to BN's rail operations as a "cash cow", and reports that even veteran BN Railroad officials fear the railroad "cow" will be "milked" to promote the holding company's plans for diversification.

We should point out to the committee that the reported plans of the BN are not without precedent. In 1977, the ICC studied the use of holding companies in the context of the rail industry and found that billions of dollars worth of rail assets have been siphoned from railroads by their holding companies.

In the case of the BN, using the railroad as a cash cow for diversification means that shipper dollars are going into assets that shippers receive no benefit from. This is particularly bad when the commodity profits come from coal, because high coal rates defeat national energy goals, and also defeat basic consumer interests, since most coal shippers are utilities, and the utilities' customers, the general public, will end up picking up part of the tab for BN's corporate acquisitions. In addition, the holding company can pressure the railroad to increase captive coal rates—a policy that BN did institute after the formation of the holding company. Finally, with the railroad as a cash cow for diversification, less moneys are available to maintain and keep up the rail network.

In response to these perceived problems with the holding company, the League asked the ICC in May of 1981 to prevent its formation pending ICC review and approval. In response, the ICC said it could not review the matter because it lacked jurisdiction. However, in February of this year, the 8th Circuit reversed the ICC's decision, and hopefully, the Commission will now decide to review the merits of BN's corporate reorganization on remand, though after listening to Chairman Taylor today, I do not know how far we will get.

In addition, at its annual winter meeting this year, the league passed a resolution endorsing the efforts of the Water Transport Association and others to prevent the holding company from stripping the railroad of its land grant holdings.

Finally, the league would support legislative initiatives designed to insure that railroad holding companies not channel away resources earned or owned by the railroad in a manner inconsistent with the interest of users of the rail network.

On behalf of the league, I would like to again thank the committee for the opportunity to appear before it today.

Senator BAUCUS. Thank you.

[The following was received for the record:]

TESTIMONY

OF

JOHN H. LESEUR

ON BEHALF OF THE

WESTERN COAL TRAFFIC LEAGUE

Mr. Chairman and Members of the Committee:

INTRODUCTION

Thank you for extending an invitation to the Western Coal Traffic League to appear and participate in today's hearings on rail mergers and the foundation of the Burlington Northern Holding Company. I am an attorney with the law firm of Slover & Loftus, and our firm acts as counsel for the League.

By way of background, the Coal League is comprised of utilities and industry that purchase and receive coals mined west of the Mississippi River. Appended as Exhibit A to my testimony is a listing of the members of the League. Overall, League members received over 20 million tons of coal last year, and paid a total of approximately 351 million dollars in rail freight charges. All members of the Coal League receive their coal by rail, and much of this tonnage is transported over the lines of the Burlington Northern Railroad Company. In view of the magnitude of the freight charges assessed against League members, and their dependence upon coal to meet the needs of their customers, the League has been active in the principal proceedings before the Interstate Commerce Commission and the federal courts involving rail coal rates and rail service matters.

My testimony this morning will focus on one issue that the League believes affects both coal rates and coal transportation service -- BN's formation of a holding company.

THE FORMATION OF THE HOLDING COMPANY

Pursuant to the management proposal submitted and approved by BN's stockholders on May 14, 1981, ownership of the

BN Railroad was transferred to a holding company. BN candidly admitted in the Proxy Statement accompanying the management proposal that the sole purpose of this corporate restructuring was to promote the development of its non-transportation resources while avoiding ICC securities regulation:

> The Interstate Commerce Act requires the Railroad to obtain prior approval of the Interstate Commerce Commission (ICC) for issuance of its securities. The authority of the ICC to grant its approval is restricted to security issuances which it finds to be reasonably necessary for, or consistent with, the proper performance by the Railroad of service to the public as a common carrier. The practical effect of this restriction, as construed by the ICC, is to prohibit the Railroad from issuing securities for the acquisition or development of non-transportation assets, thereby greatly limiting the Railroad's ability to develop such assets. Because the holding company would not be a common carrier, it would not be subject to the same restrictions as the Railroad with respect to the issuance of securities and would have greater flexibility to finance non-transportation business activities, to expand through acquisition of new businesses and to develop natural resources owned by it or its subsidiaries.
>
> Management believes that development of the Railroad's natural resources and non-railroad properties could be facilitated if transferred to the holding company or other subsidiaries of the holding company....

Separately, BN's then-President and Chief Executive Officer, Richard Bressler, wrote a letter to each ICC Commissioner on January 28, 1981, stating that formation of the holding company would "not in any way detract from our efforts to provide the necessary personnel and facilities to meet the needs of all our rail shippers." Mr. Bressler went on to underscore BN's belief that it was important "that each of our separate lines of business stand on its own feet!" (A copy of this letter is attached as Exhibit B to my statement).

Because of the League's serious apprehensions over the effect that the BN's restructuring plan would have on its coal service operations, the League requested the ICC, on May 5, 1981, to take action to prevent the formation of the holding company until it was formally approved by the ICC (see Exhibit C). Subsequently, the ICC denied the League's request, as well as petitions filed by other interested parties, on the grounds that it lacked jurisdiction to consider the legality, or public interest factors, involved in BN's holding company proposal.

As this Committee is well aware, the formation of holding companies to own major railroads has been a most controversial subject in recent years, and has been carefully analyzed by the ICC. In 1977, the ICC issued a comprehensive study of the holding company issue. See Railroad Conglomerates and Other Corporate Structures: A Report to Congress as Directed by Section 903 of the Railroad Revitalization and Regulatory Reform Act of 1976. Therein, the Commission concluded:

> The history of conglomerates in the railroad industry demonstrates that a parent company has ample power to strip its subsidiary railroad of valuable assets, to the actual or potential detriment of the carrier and of its ability to carry out its common carrier responsibilities.

Id. at 73.

The Commission's conclusion that the parent holding company has the power to "strip its subsidiary railroad of valuable assets" is real and apparent in the case of the BN.

THE BN's CASH COW

As discussed above, BN formed its holding company to accelerate its growth in non-transportation areas, but at the same time told the ICC that each of its separate lines of business would "stand on its own feet." However, recent reports in the financial press indicate that BN is taking a different tack. For example, the March 8, 1982 edition of Business Week reports that BN management is attempting to raise a billion dollars for purposes of targeting oil and lumber interests for "Marathon Oil-Type" corporate takeovers. The principal source for generating the funds needed for these capital intensive maneuvers is -- the railroad! Thus, Business Week observes that BN's rail operations are starting to "throw off cash," that BN is becoming "a massive cash machine" and that the "cash cow" to be milked for these non-rail investments is the railroad:

> BN's cash flow is expected to run roughly $100 million more than its needs in coming years. Nonetheless, union leaders, shippers, and even some veteran railroad managers at BN fear that the commitment to diversification at the corporate level will make management greedy for even more, that the railroad will become a cash cow to be milked for resource development.

(The Business Week article is attached as Exhibit D).

Similarly, BN's own April 14, 1981 Proxy Statement reveals:

> It is expected that funds for the payment of dividends and expenses of the Holding Company will initially be obtained through dividends declared by the Railroad and other subsidiaries of the Holding Company.

Id. at 5.*

THE CONSEQUENCES OF USING THE RAILROAD AS A "CASH COW"

Using the BN railroad as a "cash cow" to fuel the appetites of its parent holding company, particularly where the cash is coming from captive coal shippers, causes numerous adverse consequences to the shipper and public interests:

(1) Exploitation of Captive Coal Shippers

The boom in western coal traffic has come about because utilities and industry responded to the national need to reduce the use of oil and natural gas as a source of electrical power by turning to low sulfur western coal. Since the principal mining areas of this coal are usually located hundreds, or thousands of miles from industrial and utility centers, the only feasible method of transporting these coal volumes is by rail. Thus, western carriers exclusively serving coal origins or destinations have a virtual market lock on this traffic, and the extent to which they can exercise their monopoly power has formed the subject of numerous disputes between western shippers and carriers.

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* The ICC's 1977 Conglomerates study has previously observed that "in pursuit of diversification or for other purposes, [holding companies] have used the [cash] dividends to obtain funds from railroads free of interest costs or the obligation for repayment." Id. at 21. Transfers of non-cash assets by dividend from railroads to holding companies were also found to be commonplace. See id. at 29-34. Conversely, BN's Proxy Statement flatly asserts "Holding Company will not assume any of the debt obligations of Railroad as a result of the merger." Id. at 7.

BN is dominant in the transportation of coal out of the Powder River Basin area of Wyoming -- a principal source of low sulfur coal -- and has felt no compunction in the past to attempt to set monopoly rates on coal traffic. Indeed, due in large measure to the Energy Crisis, the principal source of BN's traffic profits comes from coal traffic. As reported in BN's 1980 SEC Form 10K, revenues from coal comprise the single largest commodity component of its freight revenues. Indeed, this Report shows that while its coal tonnages doubled from 1976-1980, the revenues it derived from coal over the same period tripled:

	Year Ended December 31				
	1976	1977	1978	1979	1980
Coal transportation revenues (in millions)..................	$273.6	$372.9	$499.2	$721.1	$944.8
Tons of coal originated (in millions)..................	42.9	50.6	63.1	80.2	100.3
Coal revenue ton miles (in billions)..................	32.1	42.6	52.7	66.2	82.5
Daily unit train originations at end of period	12	14	17	22	27

Id. at 6.

Because BN, before the advent of the holding company, attempted with much success to cash-in on captive coal traffic, the League fears that the added pressures of generating even more cash to fund non-railroad projects will lead BN to seek even greater coal rate increases. In fact, this very result is happening, as BN has instituted a highly publicized campaign designed to dramatically increase its revenues on captive coal traffic. On June 15, 1981 -- less than one (1) month after BN's stockholders approved its reorganization plan -- the President of the BN Railroad sent a letter to all of BN's major coal customers indicating that major increases were on the way. (See Exhibit E). Since that time, BN has begun to implement this plan.

It is particularly galling to members of the Western Coal Traffic League that the coal rates its members are paying and the increases BN is now attempting to foist upon them are apparently going to be used by BN to buy oil and lumber companies. While such non-transportation investments may benefit BN's shareholders, they provide no benefits to shippers using BN's transportation network, or to the interests of national rail transportation policy.

Moreover, the picture of financial health now being painted in the financial press is wholly at odds with the picture the BN has conjured up in ratemaking proceedings before the ICC and in its recent increase campaign. At the ICC, BN continually postures itself as "revenue inadequate" and in dire need of every rate increase it requests, else it go the way of the Penn Central, and other bankrupt roads. Witness, for example, a verified statement made by a BN Senior Vice President in the ongoing rate case involving Western Coal Traffic League member, San Antonio, Texas:

> The Nation's railroads, as a group, have long suffered from inadequate earnings. Unfortunately, Burlington Northern's rail operations are no exception. The historically inadequate revenue levels and earnings from rail operations make it extremely difficult for BN to continue the huge capital demands placed upon it by the movement of coal.

Docket No. 36180, Statement of Robert F. Garland at 3 (Oct. 30, 1981).

Based upon representations such as that just quoted, the ICC has permitted the BN to reap extremely high rates on coal, and the BN's current campaign shows that the carrier is out for even more.

Thus, the formation by BN of its holding company appears to have contributed to its desire to inflict rate increases on captive coal traffic in order to obtain cash for non-rail related investments.

(2) Chilling National Energy Goals

Many current shippers of western coal became coal shippers as a direct and positive response to legislation enacted by Congress calling for increased use of coal as a boiler fuel.* Coal freight rates that vastly exceed the cost of providing coal transportation service are acknowledged and serious impediments to the attainment of national energy goals. See, e.g., The President's Commission on Coal, Recommendations and Summary Findings, at 7 (March 1980); House Subcommittee on Oversight and Investigation of the Committee on Interstate and Foreign Commerce, Railroad Coal Rates and Public Participation in Oversight of ICC Decisionmaking, H.R. Comm. Print 96 I.F.C. 40, 96th Cong. 2d Sess. 92-104 (1980); Coal -- Bridge to the Future: Report of the World Coal Study, at 126-127 (1980).

The importance of focusing on national energy concerns in formulating coal rates has also been emphasized by the courts. For example, the Fifth Circuit stated in a decision involving Western Coal Traffic League member Celanese Chemical Company:

> All parties to this dispute acknowledge that transportation is a large portion of the cost of coal, and no one can dispute that the cost of coal in comparison to the cost of other energy sources is the primary factor which major industrial users will consider in deciding whether to use coal rather than oil or gas. Railroads enjoy a near monopoly in the transportation of coal. It is thus obvious that the establishing of railroad rates for the transportation of coal has a great impact on our national energy policy.

Celanese Chemical Co. v. United States, 632 F.2d 568, 578 (5th Cir. 1980).

Pressures brought to bear by the BN Holding Company on the railroad to generate cash thus may generate rate increases that serve to deter national energy goals. Indeed, high railroad freight rates have often been cited by utilities and industry alike as a principal reason for not converting facilities to low-sulfur coal.

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* In recognition of our over-dependence on imported petroleum in particular, and natural gas and oil in general, Congress has enacted a series of laws designed to reduce reliance on oil and gas wherever possible. Among them are the following: the Emergency Petroleum Allocation Act of 1973 (Pub. L. 93-511, 88 Stat. 1608); the Federal Nonnuclear Energy Research and Development Act of 1974 (Pub. L. 93-577, 88 Stat. 1878); the Energy Reorganization Act of 1974 (Pub. L. 94-438, 88 Stat. 1233); the Energy Supply and Environmental Coordination Act of 1974 (Pub. L. 93-319, 88 Stat. 246); the Energy Policy and Conservation Act (Pub. L. 94-163, 89 Stat. 871); the Energy Conservation and Production Act, (Pub. L. 94-385, 90 Stat. 1125); and the Powerplant and Industrial Fuel Use Act (Pub. L. 95-620, 92 Stat. 246).

(3) Draining the Railroad of Monies Needed to Provide Adequate Service

BN has spent substantial sums to build or rehabilitate its coal lines. However, even before the holding company was formed, major coal shippers often experienced service problems, despite the fact that they were paying premium rates for coal transportation. Coal trains are routinely sidetracked and delayed to allow other rail traffic to pass through, and accidents abound. Rail management puts inordinate energy into car and equipment technology generally -- but ignores coal cars. Indeed, in most instances, the BN will not even provide equipment.

Of course, if the railroad is now to be used as a "cash cow" there is every reason to fear that past service problems will be exacerbated and new ones will occur. Even though BN management staunchly states that they will not neglect to keep up the railroad, the ICC's 1977 Report on railroad conglomerates found:

> With few exceptions, our investigation has shown that capital and maintenance expenditures made by railroads owned by holding companies have not kept pace with inflation.

Id. at 72.

Finally, as reported in Business Week, even some of BN's railroad managers fear that upkeep and service may be given a back seat to the holding company's drive for diversification.

(4) The Adverse Financial Effect on Utility Ratepayers

Most shippers of BN coal are electric utilities. These utilities, as a general rule, pass-on BN's transportation charges to their customers as part of their monthly billings. Thus, for utilities the so-called "bottom line" rests with its customers, and it is totally unfair to these individuals and businesses to pay freight charges that are so high that the carrier is looking to buy oil companies with its excess cash. Yet, that appears to be the very result of the BN's current coal pricing program.

OTHER CONCERNS

The Coal League shares the concerns expressed by the Water Transport Association, and others, that the Holding Company plans to strip the Railroad of valuable land grant properties whose income would otherwise be available to the rail network.

CONCLUSION

By creating a holding company, BN has facilitated its ability to make non-transportation investments. Unfortunately, it appears as if the BN may take advantage of this new corporate framework to siphon-off railroad profits and assets to collect cash for its new corporate aggrandizement. Such a policy is detrimental to the interests of both shippers and the general public. In addition, monies that previously would be available to maintain the railroad may now be targeted for non-rail purposes.

Given these adverse consequences, WCTL would fully support legislative initiatives designed to ensure that railroad holding companies do not funnel away resources earned or owned by the railroad in a manner inconsistent with the protection of the interests of users of the rail network.

On behalf of the League, I would like to again thank the Committee for the opportunity to appear before it today.

Exhibit A

MEMBERS OF THE WESTERN COAL TRAFFIC LEAGUE

Arizona Electric Power Cooperative
Celanese Chemical Company
Central Power and Light Company
City of Colorado Springs
City Public Service Board of San Antonio
Houston Lighting and Power Company
Iowa Power and Light Company
Iowa Public Service Company
Kansas City Power and Light Company
Minnesota Power and Light Company
Omaha Public Power District
Tuco, Inc.

Exhibit B

BURLINGTON NORTHERN

RICHARD M. BRESSLER
President and Chief Executive Officer

176 East Fifth Street
St. Paul, Minnesota 55101

January 28, 1981

Commissioner Thomas A. Trantum
Interstate Commerce Commission
12th & Constitution Avenue, N.W.
Washington, D.C. 20423

Dear Commissioner:

On January 26 the Board of Directors authorized the management of Burlington Northern Inc. to proceed with the formation of a holding company. The matter will be presented to our stockholders for their approval at their next annual meeting on May 14, 1981. Assuming the stockholders approve the recommendation of our Board of Directors, it is our intention to promptly create a holding company.

The Board of Directors also approved a new organizational structure for the Company providing for seven separate profit centers. The principal profit center will be the railroad. In addition, we will have trucking, air freight forwarding, and four separate nontransportation business profit centers.

During the last five years we have invested in excess of $2.1 billion in capital expenditures to expand and improve our rail service. Approximately $1 billion of this amount was spent to expand and improve our capacity to transport coal. We want to assure you that the formation of such a holding company will not in any way detract from our efforts to provide the necessary personnel and facilities to meet the needs of all of our rail shippers. However, we believe it important that each of our separate lines of business "stand on its own feet." We are confident that the formation of a holding company will ensure this result and that it will allow our nontransportation businesses to grow along with the railroad and thereby make an even larger contribution to the overall corporate enterprise and to the public interest.

Because Burlington Northern operates a single, integrated transportation system, the formation of such a holding company, under existing law, does not require Commission approval. However, because this is an important step in strengthening our management structure and providing better service, I wanted to personally inform each member of the Commission of our plans.

If you want any additional information, either Mr. Grayson, our Vice Chairman and President of our Transportation Division, or I would be happy to meet with you and discuss our plans in greater detail. If you have any questions, please feel free to call or write me.

Sincerely yours,

Ron Brinegar

Exhibit C

THE WESTERN COAL TRAFFIC LEAGUE
1224 Seventeenth Street, N.W.
Washington, D.C. 20036

(202) 659-1445

May 5, 1981

The Honorable Marcus Alexis
Acting Chairman
Interstate Commerce Commission
Room 5221
Washington, D. C. 20423

Re: Burlington Northern, Inc.

Dear Acting Chairman Alexis:

As President of the Western Coal Traffic League, I am writing you to urge that you take immediate and decisive action to prevent the formation of the holding company which has been announced by Burlington Northern Inc. until it has been approved, formally, by the Commission. (see Attachment I).

The Western Coal Traffic League and its members ship and receive over 40 million tons of bituminous coal annually. The majority of this coal moves over the lines of Burlington Northern (BN) and its affiliates, and for this reason the League is vitally concerned over the future financial health and well-being of BN which is such a vital link in our national transportation system.

The League is apprehensive over the proposed restructuring of BN because of its potentially adverse impact upon the railroad's continued capacity to provide adequate and efficient coal transportation services to League members and to other coal receivers. That WCTL's fears in this connection are with good cause is shown in the Commission's report entitled Railroad Conglomerates & Other Corporate Structures, A Report To Congress As Directed By Section 903 Of The Railroad Revitalization And Regulatory Reform Act Of 1976.

Therein, following a full study of past and similar transactions in the railroad industry, the Commission concluded:

> It is our conclusion, based on the results of the investigations and studies conducted for the purpose of preparing this report, as well as our many years of regulating the surface transportation industry, that the services of this country's major railroads are too important--and that the potentials for abuse are too great--to permit the transfer of control over any one major railroad to be accomplished without appropriate regulatory agency approval. (p. 73)

Among the other findings reached by the Commission in its report were the following:

> Few holding companies have provided railroads with any tangible benefits. (p. 69)
>
> The railroads, once divested of non-carrier assets, remain a non-growth sector of the holding company group. (p. 70)
>
> ...the railroad as an instrument of public service has been deprived of wealth accumulated over many years, including resources such as land grants provided at public expense. (p. 70)

It is no understatement to say that the Commission's Railroad Conglomerates Study is a ringing indictment of the very kind of financial transaction now proposed by BN. For this reason, the Commission concluded in 1977 and represented to the Congress that it would "take action" to monitor the future creation of railroad conglomerates especially in proposed transactions governing land grant properties. (Report, p. 75)

The BN proposal calls upon the Commission to make good its promise to the public and to the Congress. The BN seeks to elude any Commission scrutiny of its proposed transaction on the basis of its self-serving representation that as a "single, integrated transportation system, the formation of such a holding company, under existing law, does not require Commission approval" (See Attachment I).

Whether BN's legal analysis is correct in light of the Commission's conclusions in its Railroad Conglomerates Study is open to question (See p. 75). Clearly, however, the BN is dead wrong on its assertion that BN is a "single integrated transportation system." The Fort Worth & Denver Railway Company and the Colorado & Southern Railway Company are independent and distinct transportation companies with separate managements, headquarters, etc., and, indeed, they are so treated by the Commission for purposes of revenue adequacy. As such, the proposed new holding company will control, at least, three (3) separate railroad companies (i.e. BN, FW&D and C&S).

Because the Commission has announced in its Railroad Conglomerates Study that it would take action in connection with future holding company proposals, especially where land grant properties are involved and because the BN's proposal will violate Section 11343 of the Act, if consummated without prior I.C.C. approval, please accept this letter as our request that the Commission take immediate and decisive action to protect the tremendous public interest at stake in this proposed multi-billion dollar transaction.

Very truly yours,

Joseph H. Shafer, Jr

Joseph H. Shafer, Jr.
President

JHS:ke

cc: Vice Chairman Robert C. Gresham (4136)

Commissioner Charles L. Clapp (3229)

Commissioner Thomas A. Trantum (5124)

Commissioner Reginald E. Gilliam, Jr. (4211)

Mr. Richard M. Bressler
President and Chief Executive Officer
Burlington Northern
176 East Fifth Street
St. Paul, Minnesota 55101

General Counsel Richard A. Allen, Esq. (5211)

The Honorable Bob Packwood, Chairman
Senate Commerce, Science & Transportation Committee
5205 Dirksen Senate Office Building
Washington, D. C. 20510

The Honorable John D. Dingell, Chairman
House Energy & Commerce Committee
2125 Rayburn House Office Building
Washington, D. C. 20515

[From Business Week, Mar. 8, 1982]

EXHIBIT D

BURLINGTON NORTHERN'S CASH COW—COST-CUTTING AND TAX BREAKS WILL GENERATE FUNDS FOR RESOURCE DEVELOPMENT

Richard M. Bressler, a former Atlantic Richfield Co. executive vice-president who became chairman of Burlington Northern Inc. in mid-1980, has made no secret of his intention to build up the company's nontransportation businesses. By naming Walter A. Drexel, a former tax accountant at ARCO, to the presidency of the Burlington Northern RR (BN) in mid-February, Bressler underscored his determination to double the railroad's profitability and at the same time to double by 1990 the share of earnings from BNI's other operations. Last year the railroad accounted for 75 percent of BNI's $478.1 million in operating income.

Drexel, 51, was recruited in 1981 by Bressler, also 51, as BNI's senior vice-president for strategic planning. As Bressler's man, he can be expected to continue BN's aggressive cost-cutting and to give Bressler the cash flow he needs to grow the holding company's resource ventures.

Tough to balance, Bressler's objectives are ambitious for a company that struggled through the 1970s. BNI's railroad subsidiary barely ran in the black. The oil, minerals, and timber on the 8.6 million acres it either owns or has mineral rights on made it theoretically rich, but the railroad did not have the cash to develop these resources. That is now changing, however, Last year, BNI netted $272.2 million on revenues of $4.9 billion, up from $229.9 million on $4 billion in 1980.

Still, with expected "very rapid increases in railroad earnings, it will be difficult to achieve [a 50-50] balance between transportation and other businesses any time soon," says Bressler. Acquisition is thus BNI's only route to rapid balance of the company. With the BN becoming a massive cash machine, and with increasing unused borrowing power at the holding company, BNI by yearend could have a $1 billion head of steam built up for a major buy. "If U.S. Steel can do it," quips one former BN executive, referring to that company's acquisition of Marathon Oil Co., "why not BN?"

The most likely target is an oil company with enough cash flow to speed the transition of BNI's Milestone Petroleum Co. unit from a collector of royalties to a full exploration and production company. Bressler is also scouting lumber mills in the Northwest with the goal of processing logs from BNI's vast timberlands.

Although weak rail traffic in the current recession could delay the cash buildup Bressler needs for his drive to build BNI's other assets, massive tax breaks from the Economic Recovery Tax Act of 1981 will help it considerably. Savings effected by a new set of cost-conscious bosses at the throttle since BN merged with St. Louis-San Francisco Ry. Co. (the Frisco) in November, 1980, also boost profitability—especially welcome because BN's return on its $2.5 billion investment to haul coal out of Wyoming's Powder River Basin is disappointing.

Major surgery on BN's bloated cost structure was begun by Richard C. Grayson, who ran the Frisco before becoming BN's chief executive in 1980. Grayson had planned to retire later this year at age 62, but will stay on as CEO of a new BNI transportation group (rail, truck, and air-freight operations). This will enable Drexel to learn the business from one of the industry's most highly respected operators. Drexel will probably return to BNI's holding company headquartaers in Seattle in a few years. He is expected to have a major say in naming his successor at the railroad.

Grayson and the team of managers he has installed at the BN from the Frisco, a smaller but more profitable road prior to the merger, have made major changes at the St. Paul-based railroad. BN's work force has been cut by 8,000, or 14%, reducing it to less than the size of the BN alone before the two railroads merged. Grayson says $70 million in payroll saving was not realized in 1981, because many of the cuts came late in the year. A new reputation. Another key move was to reorganize marketing efforts along commodity lines. And BN is trying hard to live down its reputation for high-handedness. The effort appears to be working. Says Robert L. Kessler, executive director of the Western Coal Transportion Assn: 'Their attitude is to get closer to their shippers. In the past, they just said: 'Nuts, we'll litigate,' "

Despite payroll cuts and the streamlining or operating and maintenance procedures, BN's operating ratio, or total expenses as a percentage of revenue, is still among the highest in the industry BN's goal on the cost side is ambtious—to reduce its operating ratio by 8.5 percentage points this year, to 87.7%. "We wouldn't budget it if we weren't sure we'd make it," states Grayson. Analysts are more skeptical, Says Graeme A. Lidgerwood, research analyst at Kidder, Peabody & Co. "I doubt they can achieve those improvements in the face of declining traffic and continued pressure on rates," Adds another analysis "If traffic stays weak, forget it."

The leverage from a 8.5-point improvement in the operating ratio is enormous. With it, even a modest 10% increase in revenue would boost the railroad's pretax profit by more than 50%. Provision in the new tax law would have the effect of allowing that improvement to flow right through to the profit line. In addition to faster depreciation overall, railroads also benefit from a change in how they depreciate their trackage and rights of way. Railroad accounting has carried these at historical cost until they are retired. Now they can bc depreciated over a period of 5 to 50 years. That will give BN $1.1 billion in tax writeoffs, which should free it from current tax liabilities for several years.

No neglect BN's cash flow is expected to run roughtly $100 million more than its needs in coming years. Nonetheless, union leaders, shippers, and even some veteran railroad managers at BN fear that the commitment to diversification at the corporate level will make management greedy for even more, that the railroad will become a cash cow to be milked for resource development. BNI officials insist they will not neglect the railroad citing plans for stepped-up programs to replace ties and repair branch lines, Says Drexel: "I have no intention of letting the railroad run downhill. We're not going to defer maintenance just to increase cash flow. Someday you'll have to pay the piper."

One thing is sure: BN's 29,000-mi. system—the longest in the nation—will be cut back. Last June, BN went public with its intention to abandon 2,500 mi. of lightly used branch lines in Montana, North Dakota, and Nebraska. The announcement brought down on BN the wrath of just about every farmer, grain elevator operator, and local politician in all three states. It has since dropped plans to cut 600 mi. and, it claims, ceased studying later abandonment of an additional 200 mi. of branch lines.

Continuing layoffs and the prospect of further cuts as BN shrinks its system make for uneasy relations between BN's management and its 45,000 unionized workers. Admits Drexel: "I'm sure we've burned up a lot of goodwill with our unions, but I'm not looking for confrontation." Still says one union leader, grievance loads are "rising by leaps and bounds." And BN's continued pressure for smaller train crews and other workrule changes could lead to local strikes at any time. "There is discontent in the ranks, and morale is low," says Gordon K. Williams, general chairman of the Brotherhood of Railway & Airline Clerks. "We wouldn't have any trouble takings the people out [on strike]."

Coal traffic. BN's biggest problem is still coal. Since the early 1970s, it has spent $2.5 billion to buy equipment and to build and strengthen its track out of the Powder River Basin, which contains an estimated 35 billion tons, of the low-sulfur western coal that BN once figured was the fuel of the future. BN's coal traffic has cannonballed from almost nothing to 113 million tons annually.

The investment now appears unlikely ever to earn the profits once projected. For starters, eased air pollution standards, energy conservation, and the increased availability of natural gas have dampened the demand for low-sulfur coal. And although Powder River coal accounts for more than half BN's tonnage, it provides only 30% of its freight revenues, BN claims that because it cannot sufficiently raise rates under long-term agreements, signed in the 1970s, with 15 of its untility customers, nearly half the coal moves at little or no profit. Unsuccessful efforts by the railroad's former management to have the agreements declared void have been costly. And attempts at voluntary renegotiation have been futile. Says a former BN offical: "The effort to improve coal pricing has been a major disappointment."

Stiff competition. BN made its investment on the assumption that its century-old monopoly on traffic out of the Powder River Basin would continue, but now it faces stiff competition there. Chicage & North Western Transportation Co. backed by the Union Pacific RR, has lined up $460 million in bank loans to build and upgrade track south from the basin to the UP main line. Expected to be done by 1984, the new C&NW line could be hauling 45 million tons a year of Powder River coal by 1990.

A merger of the UP with the Missouri Pacific RR, if it is completed, could further hurt BN's coal traffic. The company maintains that the single-line rate the UP would be able to offer to many BN utility customers situated along MoPac line could price BN out of the market. "If the BN is vulnerable," says the president of a competing railroad, "it is in their coast traffic." It is Drexel's job to end that vulnerability.

Exhibit E

RECEIVED JUN 1 9 1981

BURLINGTON NORTHERN RAILROAD

RICHARD C. GRAYSON
President & Chief Executive Officer

176 East Fifth Street
St. Paul, Minnesota 55101
Telephone (612) 298-7001

June 15, 1981

Mr. Arthur J. Doyle
President
Kansas City Power & Light Co.
1330 Baltimore Ave.
Kansas City, MO 64141

Dear Mr. Doyle:

I am writing to discuss a matter of mutual interest which could provide significant long term benefits to both of our companies. Recent actions taken by the Congress and the Interstate Commerce Commission have recognized that railroads must be allowed to improve earnings if they are going to be able to attract the capital necessary to construct and maintain a physical plant adequate to meet shippers' demands. The actions taken establish new thresholds for ICC jurisdiction over rates and are designed to encourage long term contracts.

Burlington Northern Railroad's (BN) 1980 return-on-assets was only 6.7 percent on a pre-tax basis. The ICC has determined that for a railroad to be competitive in the capital markets, it must earn an 11.7 return on an after tax basis. BN's estimates are 12.6 percent. Because coal constitutes over 50 percent of the transportation service performed by BN and is but about 30 percent of the revenues derived from transportation service, BN's overall financial viability is contingent upon achieving an adequate return on existing coal traffic. We simply cannot and will not continue to invest in coal related facilities with a return at the present level. To do otherwise would clearly violate our long term responsibilities to you as our customer and to our stockholders. It is clear that if BN is going to earn a return which will justify continuing investment in coal traffic, certain of our present rates are going to have to change significantly.

We believe that we now have the right to raise all of our rates to the present statutory minimum for ICC jurisdiction, which currently is a rate equal to a revenue to variable cost ratio of 160 percent. If we were to do this, it would result in significant rate increases to many of our customers, and undoubtedly, in protracted legal challenges. In an effort to improve our customer relations while increasing our return on investment, we are adopting a plan in which rates will be gradually brought up to a level that insures revenue adequacy within the next two or three years.

This plan was developed in the spirit and the hope we can resolve our differences with our customers through negotiation rather than litigation. Maximum use will be made of long-term contracts. This program should remove the need for ICC resolution of complicated--factual and legal issues, and hopefully, will also help to promote a climate of better relations between the railroad and our shippers. We will attempt to negotiate rates and contracts with all of our unit-train customers on a consistent basis.

It will be our policy to phase in any increases so as to avoid abrupt rate changes. Our goal will be to negotiate long-term contracts where possible, or in the alternative, publish tariffs which produce a reasonable return on investment. The initial ceiling for negotiations will be a rate not in excess of the statutory revenue to variable cost ratio set forth in the Staggers Rail Act. During the negotiation phase, we will seek to adjust rates to cover cost increases. Only if negotiations reach an impasse, or because of regulatory or judicial intercession we cannot accomplish our goal within a reasonable time frame, will we resort to the freedoms of the Staggers Act.

Presently, 50 percent of all BN unit train coal moves pursuant to "letters of understanding." Many of these rates are at or barely above our variable costs. It will be impossible for us to obtain adequate revenues at such levels. Consequently, we will concentrate on renegotiating rates covered by the "understandings," although we will not limit our contacts and negotiations to these customers.

This program of negotiation and explanation of our position with our utility customers is being undertaken immediately. Several months will be devoted to this effort before a further evaluation is made and a further course of action is determined.

Representatives of our Coal Business Unit will be in touch with you or a member of your organization shortly to arrange a meeting to explain our plan in detail. We want your views, your questions, and your help. This is an important matter for both of us.
We want to work cooperatively to achieve economic viability as a private sector business. We believe our plan will achieve this goal. Whether it is the best way can only be answered after we have the benefit of your critical analysis.

Sincerely,

R. C. Grayson

cc: Interstate Commerce Commission

Senator **Baucus**. John Creedy, you are the "cleanup batter" here. Please go ahead.

Mr. **Creedy**. Thank you very much, Mr. Chairman.

My name is John Creedy, and I am president of the Water Transport Association, a nonprofit trade association of the leading ICC-certificated barge lines on the Great Lakes, the inland rivers, and the intercoastal trades. Also, I am representing American Waterways Operators, the barge and towing organization.

I am going to skip over the first part of my testimony, which recounts the water carriers' attempts to bring to the attention of the ICC through regular proceedings, particularly the UP merger and their merger policy proceedings, some of the issues on the transfer of assets out of the railroads. I am going to concentrate entirely on this question of Federal aid. We look forward to your bill, Senator Baucus, and we hope that it produces better facts than have been produced before on Federal aids to the different modes.

We did a study of land grants, which I am putting in the record here, which was the first scholarly investigation of this subject in some 30 years.[1] The railroads have erupted with a national advertising campaign as a result of this study, but they have never successfully rebutted its facts. The main single point of the study is that we cannot verify the cornerstone railroad position—which you heard from Mr. Bressler this morning—that the land grants were repaid by rate concessions on Government traffic. Once put under the microscope of professional study, the railroad position turns out to be no more than a piece of sophistry, a rewriting of history.

One of the most interesting revelations is that Congress has sought to get, as you sought this morning, current value of the land grant assets and has totally failed. Despite applications to the Interior Department, the Department of Transportation, the ICC, there has been no accounting for these assets in any current terms. These grants came from the Public Treasury. The public has a right to know what the current value is. And why are they so afraid of telling us, if the value today is not truly staggering, which is what we believe.

We are not at present challenging the right of the railroads to continue holding these Government-provided assets, large as they are. We say good luck to them, but keep those assets and income in the railroads.

The logic of counting land grant income provided expressly for railroad purposes as a subsidy to be passed on to the public in some form is irresistible. Government subsidies usually are passed on. Currently, the Federal Government or State governments or local communities or shippers are being asked and expected to subsidize, and are subsidizing, essential rail services which do not meet the profit goals of the land grant railroads, profit goals, as Mr. Baxter told you this morning, which are set as a result of complete market dominance or monopoly, in many cases. In the background, of course, is the possibility that the land grant railroad itself may, one day, not meet the profit goals of the holding company.

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[1] "Federal Aid to Railroads, Part III, Grants of Public Lands to Railroads," March 1980, Jesse J. Friedman & Asso., Available from WTA, 60 East 42d St., No. 2007, New York City, N.Y. 10165.

This public policy issue really cries out for congressional investigation and action.

I do not think anybody has quoted the president of the North Dakota Farm Bureau, who stated the issue most succinctly. He said he is on a branch line that has been deteriorating for the last 7 years, and during the last 7 years, the Burlington Northern has brought in eight oil wells—obviously, if they are along a track, they would be land grant oil wells—while allowing the tracks to deteriorate. Now, there is the public policy issue. As the president of the North Dakota Farm Bureau Federation said:

> They are reaping profits of the investment of our ancestors, while denying a rightful legacy to the children.

Now, I listened to Mr. Bressler, all on this question about ICC controlling our investments, and that it is a problem to the BN. Well, the other side of that coin is that ICC can control what is done with that income. Several years ago, there was a rate increase, and as a condition of the rate increase, the ICC directed how that rate increase would be used in the railroad and its power to do so was upheld by the courts. It would have to be used for certain things—maintenance of track, catch up of the deferred maintenance, investment in equipment—so that the issue of ICC control of use of income has been established.

As you know, you have had the Congressional Research Service of the Library of Congress explain what the Congress could do in the case of the land grants, and I am sure if that study is not in the record, I would like to put it in the record.

Senator BAUCUS. It will be included.

[The following was received for the record:]

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

A LEGAL ANALYSIS OF THE LAND GRANTS OF THE NORTHERN PACIFIC RAILROAD

Pamela Baldwin
Legislative Attorney
American Law Division
October 19, 1981

EXECUTIVE SUMMARY

In 1967 the Interstate Commerce Commission approved the formation of Burlington Northern, Inc. through the merger of the Great Northern Railway Co., the Northern Pacific Railway Co., and three of their subsidiaries. The Northern Pacific Railway Co. is the successor in interest to the Northern Pacific Railroad Co., a corporation chartered by Congress in 1864 as a land grant railroad. The lands still held by Northern Pacific are rich in natural resources and were a factor considered by the ICC in approving the merger.

On May 14, 1981, the stockholders of Burlington Northern, Inc. approved a plan to create a holding company, raising the possibility that as a result of the corporate restructuring the value of the land grant holdings may now be separated from the financial operation of the railroad with resulting requests to abandon lines. This possibility has focused attention on the original language of the land grants and the intended relationship, if any, of the grants to the continued operation of the railroad.

The legislation making the railroad grants has several legal aspects. It is law, a grant of lands, and a contractual agreement between the United States and the railroad grantee.

The grants and their legislative history indicate that Congress expected that the railroads would continue to operate, but it's not clear whether 1) termination of some operations by the railroad would constitute a breach of a condition of the grants such that title to lands still held by the company would revert to the United States; 2) termination of operations by the railroad would constitute breach of a covenant of the contractual agreement between the United States and the railroad for which the United States would be entitled to contractual remedies, or 3) the expectations of Congress that the railroads would continue to operate were historical expectations without legal significance. It also is not clear whether any obligation on the part of the railroad has been fulfilled because of the passage of time and the accomplishment of the purposes of the grants, and whether any existing obligation on the part of the railroad extends to branch lines or applies only to the lines expressly mentioned in the grants.

It is clear that Congress can take action to clarify these questions, either by legislation that directs that suit be brought to determine the issues judicially, or that articulates whatever relationship between the value of the lands and the continued operation of the railroad that Congress determines to be desirable.

A LEGAL ANALYSIS OF THE LAND GRANTS OF THE NORTHERN PACIFIC RAILROAD

Introduction

In 1967 the Interstate Commerce Commission (ICC) approved a merger plan filed by the Great Northern Railway Co. and the Northern Pacific Railway Co. and three of their subsidiaries, the Pacific Coast Railroad Co., the Chicago, Burlington and Quincy Railroad Co., and the Spokane, Portland and Seattle Railway Co.[1] The resulting company was Burlington Northern, Inc. The merger was stayed during court review of the ICC findings, but became final in 1970 after review by the Supreme Court.[2]

The Northern Pacific Railway Co. was the successor in interest to the Northern Pacific Railroad Co., a corporation chartered by Congress that was the beneficiary of extensive land grants in the nineteenth century. In 1970, the Northern Pacific Railway Company was said to hold more than two million acres in fee and to have mineral rights in another six million acres. "These lands are rich in natural resources, including coal, oil, and timber and are important sources of income."[3] These assets and their value to the Northern Pacific Railway were factors considered by the ICC in approving the merger.[4] On May 14, 1981, the Burlington Northern stockholders approved a plan to create a holding company.

Because of the possibility that the value of the land holdings may now be separated from the financial operation of the railroad lines with the result that some branch lines may no longer be "profitable" and the company may apply for permission to abandon them, renewed attention has focused on the original land grants and intended relationship, if any, of the grants to the continued operation of the railroad.

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[1] Great Northern Pacific & Burlington Lines, Inc. Merger, 331 I.C.C. 228 (1967).

[2] United States v. Interstate Commerce Commission, 396 U.S. 491 (1970).

[3] Ibid., at 517.

[4] 331 I.C.C. at 234, 248-250, 255-259.

In examining this relationship, this report will consider the historical context in which railroad land grants were enacted, the language of the Northern Pacific grants and their relevant legislative history, subsequent events, and judicial interpretation of the Northern Pacific and other railroad grants.

Historical Background

A considerable amount has been written about the railroad land grants.[5] Many factors have been identified as leading to the burst of major railroad construction legislation that occurred in the middle of the nineteenth century. Among these factors were the discovery of gold in California, the impending dangers of the civil war, the absence, after secession, of opposing votes by Southern states, and a desire to encourage the settlement and development of the vast new Western territories, thereby increasing tax revenues, opening markets, and providing more adequately for the defense of the West. There was also, of course, the judgment that these transcontinental lines could not be built without substantial Federal assistance. The grants sometimes consisted only of a right of way across public lands, but sometimes also included a greater subsidy in the form of additional grants of land, financial support, or both. Some grants were made to states to be conveyed by them to a railroad company upon completion of specified segments of line. Other grants were made to corporations directly. Usually this latter course was followed if the route was to cross territories rather than states. Typically, in this latter instance, a federally chartered corporation was created by the same legislation that established the land grants.

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[5] See e.g., J.B. SANBORN, CONGRESSIONAL GRANTS OF LAND IN AID OF RAILWAYS (1981). P.W. GATES, HISTORY OF PUBLIC LAND LAW DEVELOPMENT, ch. XIV (1968).

Several transcontinental railroads were authorized within the same decade, including the Union Pacific/Central Pacific in 1862, and 1864[6] the Northern Pacific in 1864, the Atlantic and Pacific in 1866,[7] and the Texas Pacific in 1871. Not all of these were built as contemplated. The transcontinental line authorized in 1862 received only about half the amount of lands that Northern Pacific was granted where its line passed through territories, but the 1862 line received financial subsidies that Northern Pacific did not.

By the time the fourth transcontinental line was authorized in 1871, vehement opposition was developing to the railroads that only a few short years before had received such enthusiastic support. As one historian put it, when the West "...saw evidence that railroads were not prompt in bringing their lands on the market and putting them into the hands of farm makers, the West turned from warm friendship to outright hostility to railroads."[9] Attempts were made to declare forfeitures of unearned or partially earned and yet unsold grants. "In 1890 after long agitation a general forfeiture act was adopted providing that unearned grants of projected railroads should be forfeited to the United States. The measure satisfied few of the agrarians who were more anxious to have the huge Northern Pacific grant forfeited, or at least that portion along the Cascade branch which was built after 1879. The forfeiture act did cause relinquishment of some 2 million acres along the branch of the railroad down the Columbia from Wallula to Portland, which had not been built by Northern Pacific."[10] Another writer has described the forfeiture act of 1890 as "virtually an official confirmation" of the Northern Pacific grant.[11]

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[6] Act of July 1, 1862, ch. 120, 12 Stat. 489 and Act of July 2, 1864, ch. 216, 13 Stat. 356.

[7] Act of July 27, 1866, ch. 278, 14 Stat. 292.

[8] Act of March 3, 1871, ch. 122, 16 Stat. 573.

[9] GATES, supra at 380.

It appears that it was widely assumed that the lands granted to the railroad would be sold to settlers, both to raise money for the railroad companies and to promote the settlement along the railroads that in turn would provide them with business. When, however, it became clear that the railroads could and did raise money by mortgaging the lands rather than by selling them and that the railroads were retaining the lands or selling them at high prices to speculators, public opinion turned against the railroads, which increasingly came to be seen more as "monopolists" than benefactors. The 1890 legislation was viewed as weak because while Congress could have declared specific lands and grants forfeited, it did not do so. Rather it was left for the courts to determine in which instances grants were unearned or partially earned and this was seen as a victory for the railroad interests.[12]

In 1929, Congress authorized the Attorney General to bring suit against Northern Pacific for an accounting, to determine all questions of breach of conditions in the granting legislation, and to resolve all questions as to which lands Northern Pacific might be entitled. This suit was settled in 1941. As will be discussed, resolving the land grant entitlement/forfeiture questions surrounding the Northern Pacific Railway Co.'s grants proved to be complex indeed.

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[10] Ibid., at 381.

[11] D. Ellis, FORFEITURE OF RAILROAD LAND GRANTS, at 52-55.

[12] Ibid.

Legal Background

Courts that have considered the Northern Pacific legislation have held the statutes to be both grants of lands and contractual agreements that became binding upon certain acts of performance by the railroads.[13] The land grant aspects of the statutes will be considered first.

A review of basic property law concepts is helpful at this point. However, it must be kept in mind that when Congress grants lands, the grant is both a grant of property and a law and, therefore, Congress is free to specify terms or elements different from those that otherwise would apply either by virtue of the common law or earlier statutes.

To grant land usually is to convey legal title to it. Usually the conveyance of title is complete and final, but it is possible that title can be conveyed to a grantee, and then revert to the grantor in some instances. A grant may be interpreted to have been made with the understanding that it was to continue only so long as some use or circumstance continued and that if that use or circumstance ceased, then title would revert automatically to the grantor. This is called a fee simple determinable.

Or a grant may be interpreted as being made on the condition that if "x" occurs, then the grant reverts to the grantor. This is called a grant on a condition subsequent.

The principal difference between these two types of grants is that in the former instance (the fee simple determinable), no action on the part of the grantor is necessary to reassert title; title reverts by action of law as soon as the envisioned use or circumstance ceases. In contrast, if the grant is deemed to be a grant on a condition subsequent, the grantor must take some

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13/ United States v. Northern Pacific Railway Co., 256 U.S. 51 (1921).

action to reassert title upon the breach (or fulfillment) of the condition (depending on whether the grant and condition were worded positively or negatively). This action usually takes the form of a judicial proceeding to determine that the terms of the condition have in fact been met or breached. If the grantor is Congress, however, that further action maybe either through legislative action declaring that Congress finds the condition to be met or breached.[14/]

In attempting to characterize a grant a court will look to the "intent of the grantor", primarily by examining carefully the language chosen in the instrument of conveyance. Typically this search to ascertain the intent of the grantor has taken the form of looking for the presence of certain words of art in the drafting of the grant. For example, courts have looked for words like "X grants (land) to Y for so long as it shall be used for religious purposes...." in order to find a determinable fee. Here the grant itself contains the limitation that returns the title. In contrast, language that appears to make the grant and then impose a condition that will have a certain effect, is more likely to be interpreted to pass a fee on a condition: "X grants (land) to Y, but if Y uses it for a tavern, then title reverts to X". This type of language then would require further action by X to assert that the triggering condition has in fact occurred.

A court may, however, also interpret some parts of the land grant legislation as establishing a contractual agreement between the United States Government and the railroad. In this instance, the land grants may be part of the "consideration" or mutual benefit of the bargain that makes the contractual agreement binding, but be unaffected by a "breach" (failure to perform) as

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[14/] Schulenberg v. Harriman, 21 Wallace 44, 57 (1874) promised by one of the parties. In other words, if the railroad failed to do something it was contractually bound to do, title to the lands would not be affected, but the United States might have a "cause of action" (a legal right to sue) for monetary damages or for specific performance of the contract.

It also must be kept in mind that a party to an agreement may be assuming that some future event will take place or that the other party will act in a certain manner, yet those expectations may not constitute a legally enforceable part of the agreement that is struck.

Therefore, this report will examine both what Congress intended to be the legally binding obligations of the railroad and the intended relationship of those obligations to the lands granted. Both aspects must be examined in order to assess possible remedies. This report will focus these questions on the possible obligation on the part of the railroad to maintain and continue to operate the railroads that were authorized.

As will be discussed, there are numerous indications that Congress fully expected that the rail lines to be built by the Northern Pacific company would continue to operate. But these expectations may simply be a part of the historical context in which the land grant legislation was enacted and hence not an enforceable part of the bargain for which the land grants were made. Or the continued operation of the lines for which the grants were made may be an express or implied condition of the agreement that is enforceable through a cause of action for damages upon the cessation of operation of some or all of the lines. Or the continued operation of the lines may have constituted an integral part of the agreement, but only for as long as was necessary for the fundamental purposes of the legislation, e.g., the settlement of the West, to be achieved. It also is possible that the continued operation of the lines constitutes such an integral part of the agreement that termination of operation may warrant a revesting of title in the United States to whatever lands still may be held by the grantee or its successor in title.

Northern Pacific Grants

Although each of the grants to railroads was different, the grant to the Northern Pacific Railroad was fairly typical. The principal legislation was the Act of July 2, 1864, ch. 217, 38th Cong. 1st Sess., 13 Stat. 365, as modified by the Joint Resolution No. 67 of May 31, 1870, 41st Cong., 2d Sess. 16 Stat. 378. Other enactments consisted primarily of time extensions. The date for final completion of railroad construction eventually was set at July 4, 1879. Copies of all statutes referred to are attached.

In 1864, Congress created the Northern Pacific Railroad Company and authorized it to "lay out, locate, construct, furnish, maintain, and enjoy" a railroad and telegraph line from a point on Lake Superior in Minnesota or Wisconsin, westward on a line north of the forty-fifth degree of latitude to some point on Puget Sound, with a branch via the valley of the Columbia River to a point at or near Portland, Oregon. The 1870 legislation made the Columbia River route to Puget Sound the main line and authorized a branch across the Cascade Mountains to Puget Sound.

The railroad could exercise eminent domain power to obtain rights of way across private lands and also was entitled to take from the public lands adjacent to the roadbed earth, stone, timber and other materials for the construction of the road.

The authorizing legislation made several types of land grants to Northern Pacific: right of way lands, "place" lands, and "lieu" lands.

The right of way consisted of two hundred feet on each side of the railroad through the public domain, plus other land as necessary for associated buildings, side tracks, etc.

In addition, under section three of the Act the railroad received alternate non-mineral, odd numbered sections of the public lands on each side of the railroad line - ten sections per mile of roadbed where the line passed through states, and twenty sections per mile through territories. These lands were called "place" lands because once the route of the railroad was definitely located, so also were these lands. The federal public lands have always been surveyed in large grid patterns consisting of sections one mile on a side. Because the place lands were granted in alternating sections (the "checkboard" pattern) moving away from the railroad, a corridor twenty miles wide on each side of the roadbed in states and forty miles wide on each side of the roadbed in the territories was necessary to satisfy the place grants.

As to the purposes of the grants, section three states:

> And be it further enacted, That there be, and hearby is, granted to the "Northern Pacific Railroad Company," its successors and assigns, for the purpose of aiding in the construction of said railroad and telegraph line to the Pacific coast, and to secure the safe and speedy transportation of the mails, troops, munitions of war, and public stores, over the route of said line of railway, every alternate section of public land,... 15/

Section three continues with several provisos and concludes "And provided, further, That no money shall be drawn from the treasury of the United States to aid in the construction of the said 'Northern Pacific Railroad'." This was another allusion to the railroads being built along the central route which had received both land grants and financial subsidies. Many other "provisios" are scattered throughout the Act and their relationship to the land grants is not always clear.

Because lands that already had been granted, sold, reserved, occupied by homestead settlers, preempted, or otherwise disposed of were not available for the place grants, other lands were made available in lieu of those place lands.

15/ 13 Stat. 367.

The 1864 act provided that under the direction of the Secretary of the Interior, the railroad could affirmatively choose lands from among the odd numbered alternate sections within a band not more that ten miles beyond the limits of the place lands. These additional lands are referred to as lieu lands or indemnity lands.

Similar grants were made with respect to the additional line authorized between Portland and Puget Sound by the 1870 Resolution.[16/] In addition, this resolution authorized "second indemnity" belts ten miles wide on either side of the original indemnity limits. In any state or territory in which the company could not satisfy its entitlements within the land areas described in the 1864 charter, it could select lieu lands within the second indemnity limits in the same state or territory in which lands had been lost to the grant. The 1870 Resolution also contained language related to "settlement and preemption" that is not central to the focus of this report, but which has generated controversy in the past.

Mineral lands were "excluded from the operations of this act" by section three of the 1864 legislation.[17/] The Act as printed both in the Congressional Globe[18/] and in the Statutes at Large[19/] provides that in lieu of mineral lands (and that term was stated not to include iron and coal), a like quantity of "unoccupied and unappropriated agricultural lands in odd numbered sections nearest to the line of said road may be selected as above provided...." This language means that lands could be selected from the indemnity belts as set out above.

[16/] 16 Stat. 378.

[17/] 13 Stat. 367-368.

[18/] CONG. GLOBE, 38th Cong., 1st Sess., Appendix at 253, July 2, 1864.

[19/] 13 Stat. 368.

However, a close examination of the statement of the conferees as to their resolution of the differences between the proposals of the two houses indicates that this language actually was changed. As finally passed, the language read:

> Provided further, That all mineral lands be, and the same are hereby, excluded from the operations of this act, and in lieu thereof a like quantity of unoccupied and unappropriated agricultural lands in odd-numbered sections nearest to the line of said road, and within fifty miles thereof, may be selected as above provided. 20/

It appears that the grants of Northern Pacific have always been treated as including this provision. 21/ This mineral lieu lands belt extended beyond the other place and lieu belts where the road passed through states, but was within the lieu belts where the road passed through territories. In states, the basic place and lieu belts comprised a band eighty miles wide, and counting the mineral lieu belt, the entire railroad corridor was over one hundred miles wide. The place and lieu belts in the territories totaled one hundred twenty miles, within which were the mineral lieu belts totaling one hundred miles. Therefore, it may be seen that the railroad's corridor of lands was quite substantial.

Although the grants were not to include mineral lands, the statutes did not provide for classification of the lands. In 1895 Congress passed an act established a commission to classify the lands. 22/ These classifications, when approved by the Secretary of the Interior, would be final except in case of fraud.

Section four of the 1864 Act established the mechanism for patenting the lands. When twenty-five miles of the line were completed and ready for service, commissioners would so certify and patents (government deeds) to the lands would

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20/ CONG. GLOBE, 38th Cong., 1st Sess. 3459, 3479 (1864).

21/ See e.g., United States v. Northern Pacific Railway Co., 311 U.S. 317, 325 (1940).

22/ Act of February 26, 1895, ch. 131, 28 Stat. 683.

be issued to the Railroad "confirming to said company the right and title to said lands" situated opposite to, and coterminous with, said completed section of said road...."[23]

Section five[24] provided that the Railroad was to be constructed in a substantial and workmanlike manner "equal in all respects to railroads of the first class". Then follows a sentence related to the construction and operation of a telegraph line that concluded with a proviso that relates the rates to be charged the government for both the rail and telegraph service.

> And there shall be constructed a telegraph line, of the most substantial and approved description, to be operated along the entire line: Provided, That the said company shall not charge the government higher rates than they do individuals for like transportation and telegraphic service.

Section eight[25] provided that every grant made to the Railroad was made and accepted on certain conditions related to the starting and completion of work on the road. These deadlines were extended several times in later enactments.

Section nine[26] describes the grants as conditional but does not provide a clear remedy for any breach of the conditions imposed:

> And be it further enacted, That the United States make the several conditioned grants herein, and that the said Northern Pacific Railroad Company accept the same, upon the further condition that if the said coupnay make any breach of the conditions hereof, and allow the same to continue for upwards of one year, then, in such case, at any time hereafter, the United States, by its congress, may do any and all acts and things which may be needful and necessary to insure a speedy completion of the said road.

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[23] 13 Stat. 368.

[24] 13 Stat. 368-369.

[25] 13 Stat. 370.

[26] *Ibid*.

Presumably, one of the things that Congress might have considered needful and necessary to do would be to declare a forfeiture of the lands in order to undertake an alternative means of securing construction of the line.

Section eleven[27] declares that the Railroad,"... or any part thereof, shall be a post route and a military road, subject to the use of the United States, for postal, military, naval, and all other government service, and also subject to such regulations as congress may impose restricting the charges for such government transportation." (emphasis added.)

Section twelve[28] provided that acceptance of the terms of the Act was to be signified in writing by the boards of directors of the company within two years after the passage of the Act. This was done.[29]

Section thirteen[30] provided for annual reports within the company and for the manner in which charges for services would be determined. Again Congress clearly contemplated that the railroad would continue to run, but it is doubtful whether this expectation as reflected in this particular provisions rises to the level of legal significance.

Section twenty,[31] however, provides:

> And be it further enacted, That the better to accomplish the object of this act, namely, to promote the public interest and welfare by the construction of said railroad and telegraph line, and keeping the same in working order, and to secure to the government at all times (but particularly in time of war) the use and benefits of the same for postal, military, and other purposes, congress may, at any time, having due regard for the rights of said Northern Pacific Railroad Company, add to, alter, amend, or repeal this act. (emphasis added.)

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[27] Ibid.

[28] 13 Stat. 370-371.

[29] See 256 U.S. 60.

[30] 13 Stat. 371.

[31] 13 Stat. 372.

Therefore, it may be seen that there are several references both express and implied in the grants themselves to the continued operation of the railroad. The new company was authorized to construct and maintain a railroad. Section three declares that the grants were made for the purpose of aiding in the construction of the line and to secure transportation of government goods. The rail line also is declared in section eleven to be a post and military road. It is possible to interpret the language in sections three, five, and eleven as evidence that Congress contemplated a road that would continue to operate as a fundamental part of the bargain for which the lands were given. On the other hand, it also could be argued that this provision simply requires the transport of government goods and personnel if and where service is in effect and that furthermore, the provision speaks more to government regulation of that required service than it does to any intended relationship to the land grants themselves or to any contractual arrangement in exchange for those grants.

However, section twenty lends additional support to the argument that Congress intended that an operating railroad be an integral part of the bargain. Congress here stated that one of the purposes of the act was not only the construction of the railroad, but also "keeping the same in working order" and securing to the government at all times the use of the railroad. Although it is easy to see how future enactments might address the problem of keeping the line in working order, this section clearly states that that goal is one of the purposes of the 1864 Act itself. An argument could be made that the act accomplished both the construction of the railroad and keeping the line in working order because the value of the grants subsidized both aspects of the company's activities. Since section 10 of the 1864 Act gave "all people" the right to subscribe to the company's stock and forbade any mortgaging of the properties without Congressional consent, arguably Congress envisioned the land grants as accomplishing the intended results by attracting the stockholders necessary to a financially strong and solvent company and by generating initial capital from sales of the lands. Similarly, the lands also could serve the intended purposes by generating revenues as collateral assets held by the company, as contemplated in the 1870 Resolution which authorized mortgaging the properties without Congressional consent.

The converse argument, of course, would be that while Congress clearly contemplated an operating railroad, they did not do so in a legally binding sense; that the grants were intended as "start up" grants that were absolutely necessary for success of the colossal undertaking of building a railroad through untracked wilderness;[32] that the 1864 Act contemplated the prompt sale of the lands -- clearly to supply the capital that was necessary to build the road; and that the 1870 Resolution only allowed the company to mortgage the properties in recognition of the fact that adequate construction capital was not realized through either stock subscription or sales of the lands.

Both arguments are viable. On the one hand, it stretches credulity to suppose that Congress would make such vast grants in exchange only for the construction of the track. Had Northern Pacific declared its performance complete immediately upon reaching the west coast, it is doubtful that many would have agreed that the bargain had been fulfilled. Nevertheless, given the difficulties surrounding construction of the line, the anxiety on the part of Congress to complete the road, and the low value placed on the lands at the time, the point is arguable.

Even assuming that Congress did intend that an operating railroad was an inherent past of the bargain for which the lands were granted, whether Congress intended the continued operation of the railroad to be linked to title to the lands either through the granting of a fee determinable or a fee on a condition subsequent or whether Congress contemplated the operation of the railroad as an implicit, and to some extent express, part of the bargain for which damages could be demanded upon breach is not clear from the face of the statute. Unfortunately, the legislative history does not supply much additional clarification.

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[32] As to the history of the construction of the main and branch lines, see United States v. Northern Pacific Railway Co., 311 U.S. 317, 327, 328 (1940).

As will be discussed more fully later in this report, section 20 expressly reserves to Congress the power to amend the land grant legislation to keep the line "in working order." Therefore, Congress could resolve by amendments the ambiguities in the earlier language.

Legislative History of the Northern Pacific Railroad Act

Two bills were introduced in the 38th Congress (1864) to provide for a northern route transcontinental railroad. The first was H.R. 5, a bill that was very similar to the final enactment except that instead of establishing a federally chartered railroad corporation, it made grants to and authorized the People's Pacific Railroad Company, a Maine corporation, to construct and operate the railroad. Uneasiness with this state corporation resulted in the defeat of the bill and the introduction of H.R. 483. This latter bill was quite similar to H.R. 5 except for the differences relating to the corporation. Most of the discussions on the floor were addressed to H.R. 5. Therefore, consideration of H.R. 5 as well as H.R. 483 is undertaken in this report. Debate on H.R. 5 addressed the general concerns surrounding the authorizing of the northern route, while discussions of the latter bill comprised refinements of issues and ideas already aired.

H.R. 5 was introduced by Thaddeus Stevens, who also was the principal House spokesman for H.R. 483. The floor discussions on H.R. 5 reveal that the purposes of the subsidized railroad were to provide marketing outlets for the vast new territories, encourage the agricultural development of those areas, assist commerce by joining the Great Lakes with the west coast, and provide security from British and Indian attacks.[33/] Discussion of the land grants focused primarily on their value relative to the goals to be accomplished. Several speakers pointed out that the lands were not worth much at that time because of the undeveloped nature of the country, and were available at nominal rates for homesteading anyway, whereas the national government would benefit more from the increased tax revenues and productivity of the area after it was developed.

Although speakers several times referred to the grants as being "in aid of construction", it is equally clear that the continued operation of the railroad was contemplated. The entire concept of authorizing the railroads was premised on their continued operation. For example, Rep. Stevens says: "The value of our northwestern possessions depends upon their being populated, and their population depends wholly on the construction of such a road."[34/] Obviously, he did not mean the mere construction of the road, but its continued operation as well. Yet the intended legal consequences of these expectations, if any, are not made clear. This ambiguity is the essential and recurring problem in interpreting the grants and Congressional intent.

Section 8 of H.R. 5 expressly conditioned the land grants on certain construction by the railroad company within stated time limits. Section 9 then originally provided that if the company made any breach of the conditions that continued for upwards of one year "the United States, by its Congress, may do any and all

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[33/] See comments of Rep. SWEAT, 66 CONG. GLOBE 1699-1702, 1864; DONNELLY, 67 CONG. GLOBE 2293-2295 (1864); MORRILL, 67 CONG. GLOBE, 2295 (1864); and STEVENS, 67 CONG. GLOBE 2296 (1864).

[34/] T. STEVENS, 66 CONG. GLOBE 2296 (1864).

acts and things which may be needful and necessary to insure a speedy completion of said road." It is arguable which conditions were meant. For example, Section 13 provided that the company had to obtain certain subscriptions to stock within certain time limits or the act would be null and void. It also may well be that both express and implied conditions were meant by the language in section 9. It also was not clear, of course, exactly what Congress would do after breach occurred.

Rep. Kasson questioned whether there "ought not to be a provision which, on my motion, was incorporated into a resolution amendatory of an act granting lands to certain railroads, which operates, without legislation, a return of the lands granted and not earned by construction, at any period when the provision with reference to construction is not complied with."[35/] A short time later, an amendment was proposed by Rep. Sloan, who stated: "I think the grant is not sufficiently guarded in case this company fails to comply with the conditions and provisions of this bill." His amendment struck the language about Congress doing whatever was necessary to insure a completion of the road and substituted "the lands hereby granted shall revert to the United States and the grant hereby made shall be null and void." This amendment was agreed to.[36/] However, H.R. 5 did not pass.

H.R. 483 was introduced by Rep. Stevens on May 23, 1864, only 7 days after the defeat of H.R. 5. The new bill was "recommitted" to the select committee on the Pacific Railroad.[37/] This bill provided for a federally chartered corporation to establish the "People's Pacific Railroad Company" and appears to be

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35/ Rep. Kasson, 67 CONG. GLOBE 2292 (1864).

36/ 67 CONG. GLOBE 2293 (1864).

37/ 67 CONG. GLOBE 2427 (1864).

very similar to the original H.R. 5 except for the elimination of the Maine corporation. On May 31, 1864, Rep. Stevens offered a "substitute for the bill." This bill is not included in the bound compilation of bills for the 38th Congress, and hence is not available to us, but probably again is similar to H.R. 5 except for the change in name and corporate structure of the railroad. The substitute bill must have renamed the Corporation the Northern Pacific Railway Company. As to the substitute bill Rep. Stevens stated:

> I do not intend to make a speech upon it, inasmuch as the bill has been already fully discussed. I simply want to explain the difference between the substitute which I offer and the original bill. The bill on your files is, so far as the land grants are concerned, just the same as the bill which was rejected the other day, making the charter by the Maine Legislature the charter of the company....The substitute gives the precise quantity of land as in the bill;..." 38/

Rep. Stevens also noted that the line location was moved somewhat and that the alternate sections could only be selected within the limits of ten miles of the line of the road. He further noted that the remaining government land would be sold for $2.50 an acre, twice the existing rate. As discussed above, however, these lands also were open for homesteading and other forms of settlement and preemption and lands claimed for homesteading netted the government much less. Also, the increased rate applied only to the government land sections with the "place" grant limits. Therefore, since the bill did not include any requirement that the government sell the remaining lands, the increased price did not apply to all the lands, and since the lands frequently were not actually sold, it does not appear to be true, as the railroads frequently allege in asserting that the land grants have been "paid off", that the government reaped great revenues from the sale of the lands retained after the railroad grants.

38/ 67 CONG. GLOBE 2611 (1864).

The substitute H.R. 483 passed the House the same day it was introduced, with very little additional discussion.[39]

Many amendments were proposed and passed in the Senate, again with little discussion. What discussion there was in the Senate consisted only of comments about the vast size of the land grants being made and the vital importance of obtaining a northern rail line.[40]

A conference committee was appointed, consisting of Thaddeus Stevens, L.D.M. Sweat, and I. Donnelly on the part of the House, and J.R. Doolittle, Ira Harris, and J.W. Nesmith on the part of the Senate. The House agreed to most of the Senate amendments, but suggested alternative language with respect to the mineral lands indemnity belt.

However, the conference committee that was appointed to work out differences between the House and Senate bills proposed compromise language with respect to the selection of mineral lieu lands to lands as described above and added the phrase: "...and within fifty miles thereof, may be selected as above provided." This language was concurred in by both houses,[41] but for some reason was not printed in the final version of the law in both the Congressional Globe[42] or the official Statutes at Large.[43] This fifty mile mineral indemnity belt therefore extended ten additional miles beyond the place and lieu belts where the road passed through states and was ten miles inside the place and lieu belts where the road passed through territories. Although this fifty mile mineral indemnity belt was not technically the law, it was treated as though it were by both the parties and the Supreme Court in *United States* v. *Northern Pacific Railway Co.*[44]

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[39] 67 CONG. GLOBE 2612 (1864).

[40] 68 CONG. GLOBE 3291 (1864).

[41] 68 CONG. GLOBE 3459, H. 3479 (1864).

[42] 68 CONG. GLOBE, Appendix at 254 (1864).

[43] 13 Stat. 368.

On July 1, 1864, both the House and Senate concurred in the report of the conference committee[45] and the enrolled bill was signed by the President on July 2, 1864.[46]

On the subject of breach of conditions, H.R. 483 as introduced did not contain the amended H.R. 5 language on reversion of grants upon breach. Rather the express contingency section (section 9 in the enacted law) was weakly worded as it was in the original H.R. 5. On the other hand, H.R. 5, as finalized, had ended with a reservation of power to Congress to amend or repeal the act. H.R. 483 repeated that concept but also contained language that articulated the purposes of the statute and indicated that one of those purposes was to insure that the railroad would be kept in working order. In this respect the later bill clarifies the important point that Congress did contemplate some obligation on the part of the railroad to continue operation.

In his comments on his substitute bill, Rep. Stevens did not comment on the differences between his bill and H.R. 5 either as to the breach language or the purposes language. Since both H.R. 483 as introduced and the act as passed were alike on these topics, it is clear that the Stevens substitute bill also contained the H.R. 483 language -- original H.R. 5 wording as to breach and new language as to purpose. No other speakers commented on the absence of the reversionary language that had been approved only a few days before.

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[44] 311 U.S. 317, 329 (1940). Brief for the United States at 11, Appendix to Brief for the United States, at 41; Brief for Northern Pacific Railway Company, et al, at 3.

[45] 68 CONG. GLOBE 3459, 3479 (1864).

[46] 68 CONG. GLOBE 3482 (1864).

It is difficult to say whether the elimination in H.R. 483 of the amended H.R. 5 language making reversion automatic for failure to comply with the conditions of the grants was intentional. The use of new language in the final section of H.R. 483 makes it arguable that the drafters did consider the language chosen — since H.R. 483 was not merely a repetition of H.R. 5. Congress, of course, is presumed to mean what it says.

It is arguable considering only the enacted language on the subject of breach of conditions that a fee simple determinable was not intended, but that either a fee on a condition subsequent or a contractual cause of action for damages may have been. If the latter interpretation is correct, it would be up to Congress in subsequent legislation to make a determination that a breach had occurred and to declare the appropriate remedy. As will be discussed, judicial interpretation of similar land grants provides further illumination on these issues.

Although section 9 provides that "the United States, by its congress, may do any and all acts and things which may be needful and necessary to insure a *speedy completion* of the said road", the final section 20 is worded more broadly. Under that latter section, "Congress may, at any time, having due regard for the rights of said Northern Pacific Railroad Company, add to, alter, amend, or repeal this act" to better accomplish the object of the act. Those objects were stated to be "to promote the public interest and welfare by the construction of said railroad and telegraph line, *and keeping the same in working order, and to secure to the government at all times (but particularly in time of war) the use and benefits of the same* for postal, military, and other purposes..." (emphasis added)

Therefore, while Congress arguably did not intend that the lands be conveyed by fee determinable, Congress expressly reserved to itself the power to make later adjustments to the bargain struck with Northern Pacific in order to insure that the purposes of the legislation were served. A later Congress *always* has the power to amend enactments of a previous Congress, so this language merely *emphasized* that the legislated agreement was subject to subsequent modification.

It is probable that the reference to "having due regard for the rights of said Northern Pacific Railroad Company" is a recognition of that company's rights to due process. For example, if Congress later were to declare a forfeiture of the company's lands, the company arguably must be allowed an opportunity to be heard and to present claims for appropriate compensation considering vested rights and any asserted partial performance. In other words, this language does not preclude Congress from taking later action, but rather the language is a reminder that whatever Congress may do must be in accord with the requirements of the Constitution. Obviously, however, these requirements may constitute significant limitations. If, for example, the later action is held to be a "taking" of fully vested unconditional rights of the railroad, a court could find the statute unconstitutional or that full compensation was owed.

Subsequent History

Since enactment, the Northern Pacific land grants have been the subject of continuing controversy and judicial and Congressional attention.

In 1890 Congress passed a general forfeiture act[47] that restored title to the United States to "all lands heretofore granted to any State or to any corportation to aid in the construction of a railroad opposite to and coterminous with the portion of any such railroad not now completed, *and in operation*, for the construction *or benefit* of which such lands were granted;..." (emphasis added)

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[47] Act of September 29, 1890, ch. 1040, 26 Stat. 496.

The 1890 legislation was debated extensively, and it is clear from the comments made that the issue had been before Congress many times before. Northern Pacific was one of the railroads on which attention was specifically focused. Several speakers alleged that the company had failed to live up to the conditions in the grant and also had secured unfair advantages over the settlers and miners who went to the western areas. It was asserted, for example, that the railroad, together with the Department of Interior, had manipulated a series of "locations" of its line with attendant withdrawals of lands that prevented settlers from entering huge areas.[48/] It also was asserted that fraudulent or near fraudulent acts resulted in the company's selection of valuable mineral lands in contravention of the statute.[49/] These allegations were later to be made by the government in a suit against Northern Pacific.

At several points a fundamental difference in approach can be seen between the House and Senate. In the past, the House had favored declaring railroad lands forfeited if the line was not constructed in compliance with all of the conditions of the grants -- in particular in compliance with the conditions as to timely performance. The Senate was in favor of forfeiting only lands associated with segments of line not completed as of the date of the legislation. The House approach would have resulted in vastly greater forfeitures, but attempts to pass legislation that addressed conditions other than construction consistently had failed before. Therefore, there was considerable support by 1890 for passing the milder version in order to recoup at least some lands.

[48/] See e.g., comments of Sen. Morgan beginning at 21 CONG. REC., S 9953 (1890).

[49/] See e.g., comments of Sen. Morgan, 21 CONG. REC., S 9966-69 (1890).

Many speakers commented bitterly on the advantages the railroads were securing with the watered down legislation.[50]

There is considerable confusion in the debates as to the legal import of the Northern Pacific grants language and as to the alternatives left available to Congress in light of judicial interpretation of the grants. However, a study of these issues was not ordered at that time. There was also concern that the final conference version omitted a House provision that had specified that Congress reserved the right to declare other forfeitures in the future. The conferees gave assurances that the language was omitted because it was unnecessary and that Congress always retained the right to legislate further.[51]

The discussions centered on issues involving the construction of lines rather than their operation, probably because the courts then were addressing the issue of when title vested on behalf of the railroads, and because those railroads that were constructed were still operating. However, speakers on at least two occasions referred to the continued operation of the lines as relevant to a consideration of forfeiture.[52]

The 1890 statute did not, however, declare any particular lands forfeited. Judicial action therefore was necessary in every instance in which railroad title was in dispute. This fact led to continued dissatisfaction on the part of some members who represented settlers in the areas of the grants. Numerous controversies arose between the United States and the Northern Pacific Railroad Company and its successor the Northern Pacific Railway Company, notably disagreement over the validity of certain federal withdrawals to establish national forests made from within Northern Pacific's indemnity lands areas. The United States filed suit to cancel patents inadvertently and mistakenly issued to the company to certain of the withdrawn lands,[53] and sentiment increased for a full investigation of Northern Pacific. In 1924 Congress passed a joint resolution[54] directing the Secretary of the Interior to withhold approval of any further adjustment of the Northern Pacific land grants or issuance of patents. The resolution also authorized a joint committee of Congress to be appointed to investigate the grants and the performance of the railroad company to date. These studies took five years and fill numerous volumes of materials. Time constraints have prevented the review of these materials.

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[50] See e.g., the comments of Sen. Morgan who characterized the bill as a "robbery" 21 CONG. REC. S 9971 (1890).

[51] 21 CONG. REC. H 10420 (1890). Comments of Rep. Payson.

[52] See 21 CONG. REC. H 7377, H 7382 (1890).

In 1929 the Committee completed its report and recommended passage of a bill authorizing suit by the Attorney General to determine the respective rights of the United States and the Northern Pacific Railway Company to the end that the land grants be finally adjusted and the interests of both parties protected.[55]

Also in 1929, such legislation was passed authorizing the Attorney General to institute a court action to settle "all questions of law and fact, and all other claims and matters which may be germane to a full and complete adjudication of the respective rights of the United States and said companies, or their successors in interest under said Act of July 2, 1864...."[56] The Act made it clear that the court was to consider all questions affecting the respective claims to lands asserted by the parties including "to what extent the terms, conditions, and covenants, _expressed or implied_, in said granting Acts have been performed by the United States, and by the Northern Pacific Railroad Company, or its successors,..."[57] and "what quantities in lands or values said companies have received in excess of the full amounts they were entitled to receive, either as a result of breaches of the terms, conditions, or covenants, either expressed or implied, of said granting Acts..." (emphasis added)[58] The Act also confirmed the federal forest withdrawals and authorized appropriate compensation if any was due as a result, and declared a forfeiture of all unsatisfied indemnity selection rights of the company together with all claims to additional lands,[59] but stated that the act did not affect the present title of the company to rights of way actually used in the operation of the road.[60] (emphasis added).

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[53] This suit reached the Supreme Court in _United States_ v. _Northern Pacific Railway Company_, 256 U.S. 51 (1920).

[54] H.J.R. 237, 43 Stat. 461.

[55] S. Rep. No. 5, 71st Cong., 1st Sess.

[56] Act of June 25, 1929, section 5, ch. 41, 46 Stat. 41, 43.

A later act provided for direct appeal of the case from the District Court to the Supreme Court.[61]

Section three of the Act again reserved to Congress the right to add to, alter, amend, or repeal earlier provisions and expressly stated that the 1929 Act "shall not be construed as in anywise evidencing the purpose or intention of Congress to depart from the policy of the United States expressed in the resolution of May 31, 1870, relative to the disposition of granted lands by said grantee, and the right is hereby reserved to the United States to, at any time, enact further legislation relating thereto."

The suit was filed in 1930 in the District Court for Eastern Washington. The various motions to dismiss were referred to a master of the court who ruled on the motions, took testimony on some special pleas which had not been dismissed, and recommended decisions. Both sides filed exceptions to the various decision of the master and after the acceptance of the master's recommendations and denial of exceptions by the court, appeals were taken to the Supreme Court in 1940. The Court ruled on some issues, was evenly divided and reserved judgment on others, and returned others to the trial court for full trial. At this point a settlement agreement was submitted to the court by the parties, was accepted and incorporated as the decree of the court.[62/] Therefore, there was never a final ruling on many issues as to breach of conditions.

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[57] Ibid.

[58] Ibid., section 6.

[59] Ibid., section 2.

[60] Ibid., section 4.

[61] Act of May 22, 1936, ch. 444, 49 Stat. 1369.

The stipulation of the parties that later became the decree stated it was a full and complete settlement of all the rights and claims of the parties "which have been presented or might have been presented herein under."[63/] Because there was no issue at that time as to the continued operation of the railroad, and the basic thrust of the litigation was to resolve questions as to land entitlements, the 1941 decree does not seem to foreclose the current inquiry.

Simultaneous with the progression of the litigation, Congress was holding hearings on the issue of eliminating the provisions in the law that required the land grant railroads to carry government goods and passengers at reduced rates. The facts as to the reduced rates and the relationship of the elimination of those provisions to issues on satisfaction of the purposes of the land grant statutes is another area beyond the scope of this report that should be examined further.

[62/] United States v. Northern Pacific Railway Company, 41 F. Supp. 273 (1941).

[63/] Ibid., at 290.

Judicial Interpretation

As has been noted, the land grants made to Northern Pacific have generated considerable litigation over the years. The courts have considered the language of the grants and others similar to them in connection with various important issues, but the intent of Congress as to the relationship of the land grants to the continued operation of the railroad does not seem to have been directly decided. (Though time constraints have precluded an exhaustive search of all of the legion of railroad cases.) Some of the cases, however, have included language that bears on the issue.

The case of Schulenberg v. Harriman[64] was one of the first in which the Supreme Court considered railroad land grant language. Some of the general observations the Court made in that case have been followed consistently since. The Court held that grants made with language similar to that of section 3 of the 1864 Northern Pacific legislation were grants "in praesenti", or present grants,[65] which, because the actual line of the road was not yet located, were considered to "float" (a term which came into use later) until the route was located, at which time title related back to the date of the act.[66]

Furthermore, the Schulenberg Court stated: "A legislative grant operates as a law as well as a transfer of the property, and has such force as the intent of the legislature requires."[67] It further reasoned that the conditional language of the grants, even where the grant contained the language "the land shall revert" created a conditional, rather than determinable, estate; and that breach of condition could only be asserted by the government as grantor.[68] As to how this assertion of breach and forfeiture was to occur where the grantor was Congress, the Court stated:

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[64] 21 Wall. 44 (1874).

[65] Ibid., at 60.

[66] Van Wyck v. Knevals, 106 U.S. 360, 365 (1882)

[67] Schulenberg, supra, at 62.

> In what manner the reserved right of the grantor for breach of the condition must be asserted so as to restore the estate depends upon the character of the grant. If it be a private grant, that right must be asserted by entry or its equivalent. If the grant be a public one it must be asserted by judicial proceedings authorized by law, the equivalent of an inquest of office at common law, finding the fact of forfeiture and adjudging the restoration of the estate on that ground, or there must be some legislative assertion of ownership of the property for breach of the condition, such as an act directing the possession and appropriation of the property, or that it be offered for sale or settlement. At common law the sovereign could not make an entry in person, and, therefore, an office-found was necessary to determine the estate, but, as said by this court in a late case, "the mode of asserting or of resuming the forfeited grant is subject to the legislative authority of the government. It may be after judicial investigation, or by taking possession directly under the authority of the government without these preliminary proceedings." [69]

Several factors are important to emphasize in this opinion: 1) conditions in railroad land grants are likely to be interpreted as conditions subsequent rather than determinable fees, 2) therefore, some action by the Federal Government is necessary to reassert title, and 3) that action may either be by judicial proceeding or legislative action.

If Congress decides to act legislatively, the action taken by Congress must be legally equivalent to the judgment of office found at common law. "Legislation to be sufficient must manifest an intention by Congress to reassert title and to resume possession. As it is to take the place of a suit by the United States to enforce a forfeiture, and judgment therein establishing the right, it should be direct, positive and free from all doubt or ambiguity."[70]

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[68] Ibid., at 62-63.

[69] Ibid., at 63-64. (footnoted omitted)

[70] St. Louis, Iron Mountain and Southern Railway Company v. McGee, 115 U.S. 469, 474 (1885).

Also as to legislative declaration of forfeiture, the Supreme Court has said:

> But while we think the practice of forfeiting by legislative act is too well settled to be now disturbed, we do not wish to be understood as saying that this power may be arbitrarily exercised, or that the grantee may not set up in defence any facts which he might lay before a jury in a judicial inquisition. It would comport neither with the dignity of the Government nor with the constitutional rights of the grantee, to hold that the Government by an arbitrary act might devest the latter of his title when there had been no breach of the conditions subsequent, or when the Government itself had been manifestly in default in the performance of its stipulations. The inquiry in each case is a judicial one, whether there has been, upon either side, a failure to perform, and it makes but little practical difference whether such inquiry precedes or follows the reentry or act of forfeiture. 71/

In other words. Congress may authorize a suit to be brought to ask the courts to ascertain whether existing statutory conditions have been breached and what remedy should result -- as was done in the 1929 legislation authorizing suit against Northern Pacific. Or Congress may declare legislatively that breach has occurred and prescribe the remedy, leaving it up to the grantee then to sue if it believes its rights were violated.

As to the language of the Nothern Pacific land grants themselves, in Northern Pacific Railway Company v. Townsend 72/ the Supreme Court interpreted the 1864 language "And be it further enacted, That the right of way through the public lands be, and the same is hereby, granted to said Northern Pacific Railroad Company, its successors and assigns, for the construction of a railroad and telegraph as proposed..." as conveying a limited fee, made on an implied condition of reverter in the event that the company ceased to use or retain the land for

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71/ Atlantic and Pacific Railroad Company v. Mingus, 165 U.S. 413, 434 (1897).

72/ 190 U.S. 267, 271 (1903).

the purpose for which it was granted. Although this holding was later modified[73] and the nature of the right of way property interest is complex, it should be noted that the Court felt a Congressional purpose to *continue operation* of the road was implicit in the expression "for the construction of." The Court in the later case referred to similar language in the grant to Union Pacific: "Moreover, this right of way was granted Union Pacific 'for the construction of said railroad and telegraph line.' That purpose is not fulfilled when the right of way is used for other purposes....It would seem that, whatever may be the nature of Union Pacific's interest in the right of way, drilling for oil on or under it is not a railroad purpose within the meaning of § 2 of the Act."[74]

The Supreme Court also has said that the grants were not a gift, but rather were the consideration for a contractual agreement between Congress and the grantee railroad.[75] Specifically with respect to the Northern Pacific, the Supreme Court stated:

> The purpose of the granting act and resolution was to bring about the construction and operation of a line of railroad extending from Lake Superior to Puget Sound and Portland through what then consisted of great stretches of homeless prairies, trackless forests and unexplored mountains, and thus to facilitate the development of that region, promote commerce, and establish a convenient highway for the transportation of mails, troops, munitions and public stores to and from the Pacific coast, with all the resultant advantages to the Government and the public. To that end the act and resolution embodied a proposal to the company to the effect that if it would undertake and perform that vast work it should receive in return the lands comprehended in the grant. The company accepted the proposal and at enormous cost constructed the road and put the same in operation; and the road was accepted by the President. Thus the proposal

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[73] 353 U.S. 112 (1957).

[74] *Ibid.*, at 114.

[75] *Burke* v. *Southern Pacific Railroad Company*, 234 U.S. 669, 680 (1914).

> was converted into a contract, as to which the company by performing its part became entitled to performance by the Government. 76/

Although the Supreme Court in both of the above cases emphasized the importance of the construction of the railroad as providing the fundamental consideration to the U.S. Government, in neither case was any issue involving the continued operation of the railroad before the Court. Therefore, this language is not the final characterization that the railroads sometimes assert.

In St. Paul and Pacific Railroad Company v. Northern Pacific Railroad Company 77/ the Court determined that the Northern Pacific grants were in praesenti and that the patents issued upon completion of each section of the road confirmed that title. On this latter subject the Court also said that the patents "would not only identify the lands as coterminous with the completed section, but they would be evidence that, as to that portion of the road, the conditions of the grant had been complied with, and that it was thus freed from any liability to forfeiture for a disregard of them. 78/ The Court was overstating the situation in this last sentence, since clearly there are circumstances in which a patent may be cancelled. 79/

The Supreme Court also has interpreted language similar to sections 9 (that upon breach Congress could take action to insure "speedy completion" of the road), and 20 (Congress reserves the right to add, to alter, amend or repeal the act to accomplish the objects of the act) of Northern Pacific's grants as not limiting Congress to the remedy of building the road itself upon breach of a condition

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76/ United States v. Northern Pacific Railway Company, 256 U.S. 51, 63-64 (1921).

77/ 139 U.S. 1, 5 (1891).

78/ Ibid. at 6.

79/ See e.g., 311 U.S. 356.

by a grantee railroad company. Rather, Congress retained that option in addition to others, including forfeiture. The Court characterized conditions in railroad grants generally as conditions subsequent and said: "No express provision for a forfeiture was required to fix the rights of the Government. If an estate be granted upon a condition subsequent, no express words of forfeiture or reinvestiture of title are necessary to authorize the grantor to reenter in case of a breach of such conditions."[80/]

The litigation raising issues as to breach of conditions arose in the context of the failure of the railroads to construct line segments or to construct them on time. Therefore, the cases typically speak in terms of construction rather than continued operation. Still it is an inescapable fact that the courts have always considered forfeiture as related to issues involving construction of the lines and this connection may be more than historical coincidence. It may well be that, given the severity of the remedy, absent Congressional instructions, a court would not impose forfeiture as the solution for a breach other than failure timely to construct.

However, cases resulting from certain breach of condition in the grants to the Oregon & California Railroad Company further illuminate this question. The rail line in that instance had been completed by a successor in interest to the original company that received land grants under 1866 and subsequent legislation, but the company had not sold some of the granted land to settlers as was required under terms of the grants. Congress directed the Attorney General to bring suit to enforce the provisions. The Supreme Court in considering the resultant suit considered the primary purpose of the land grants to be the construction of an

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[80/] Atlantic and Pacific Railroad Company v. Mingus, 165 U.S. 413, 427-428 (1897).

operating railroad[81] and observed that to view the sales to settlers proviso as a condition subsequent to the fee patented to the railroad with the result that forfeiture was enforced might actually impair that basic objective of Congress. The Court also noted that the grants conveyed rights as well as obligations to the railroads and absent any express language in the grants prescribing forfeiture as the remedy for this particular provision, the court would rely on the principle that conditions subsequent are not favored but are always strictly construed. The Court therefore characterized the provision as a *covenant* rather than a condition, indicated that a contractual solution to the breach of covenant was appropriate, and enjoined the company from any further sales until Congress could consider the situation and legislate an appropriate remedy.

Although the resulting legislation avoided characterizing the provision as a covenant or a condition, Congress apparently disagreed with the Court's perception of the breach. The legislation set out the historical context, stated that the company had "willfully violated the terms" of the grants, and revested title to the lands in the United States.[82] The Supreme Court in its second consideration of the same matter upheld the legislation noting that the original grants operated as laws and were:

> subject to amendment if the right of amendment existed or accrued. There was a reservation in them of the right of alteration or repeal and if it could not be exerted to take back what had been granted and had vested, it could be exerted to accomplish the remedy which the court adjudged to the Government for the violation by the railroad company of the provisions of the grants. It is no answer to the exertion of the power and remedy to say that the acts of Congress were initially complete and absolute grants. It is to be borne in mind that they carried with them covenants to

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81/ *Oregon and California Railroad Company* v. *United States*, 238 U.S. 393, 416 (1915).

82/ Act of June 9, 1916, ch. 137, 39 Stat. 218.

> be performed and necessarily an obligation to perform them, with remedies for breach of performance. Such was our judgment, as we have seen, and the judgment was adapted to the conditions created by the breaches, and for this legislation was deemed necessary. [83]

Therefore, in view of the fact that Congress has in the past declared title revested in the United States for breach of a condition (or covenant) that was not essential to the functioning of the line itself and been upheld in that action, it certainly could be argued that Congress could do the same where the breach was failure to continue operation of the railroad.

Certain other language in the O. & C. cases also is helpful. The Court in the first case considered the gradation of remedies in the land grant statutes and noted that section 8 of that company's original grant required that the road should be kept in repair and fit for use or the United States might put the same in repair and use and repay its expenditures from the road's income or fix pecuniary responsibility upon the company not exceeding the value of the lands granted. [84] Although this language does not occur in the Northern Pacific grants (and probably did not preclude forfeiture even with respect to the O. & C. line), it does suggest another possible remedy that Congress might find suitable in the instant case. Congress may provide for alternative service and require Northern Pacific to pay for the cost of the substitute.

Also, in the first case the Court noted that because the acts of Congress were laws as well as grants, the contentions of the railroad based on waiver, acquiescence, estoppel, laches, and statute of limitations did not avail them relief, though the Court indicated that it also had reviewed later related statutes to ascertain if any governed. [85]

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[83] Oregon and California Railroad Company v. United States, 243 U.S. 549, 559 (1917).

[84] Act of July 25, 1866, ch. 242, 14 Stat. 239.

[85] 238 U.S. 427.

The Court in both O. & C. cases noted that because the grants also were laws, the railroads should have sought relief from obligations under them "through appeal to Congress" and not by an evasion of them or a defiance of them.[86/]

Finally, as discussed above, the complex 1940 case by the government against Northern Pacific provides a concise review of the history both of the grants and the sources of contention between the company and the government. None of the issues before the Court related to the issue of an obligation on the part of the company to continue operation.

Discussion and Summary

As has been seen, it appears both from the language of the Northern Pacific grants and the legislative history surrounding their enactment that Congress did envision a constructed and operating railroad as the purpose and result of the land grants.

As has also been seen, however, the intended legal import of those expectations is not clear. The continued operation of the road could constitute a condition subsequent to title to the lands, such that the courts or Congress could declare title to the lands revested in the United States upon failure of the condition. Or the continued operation of the road could constitute a covenant that is part of the contractual agreement between Congress and the Northern Pacific and its successors in interest, such that the United States would be entitled to damages for breach. Or the demonstrated expectations of a continuing endeavor could be interpreted as peripheral, historical suppositions without legal consequence.

It must also be asked if Congress intended the value of the lands to sustain the operation of the lines indefinitely and forever. It certainly could

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[86/] 238 U.S. 423, 243 U.S. 555.

be argued that since the West has been settled and developed and other technologies have provided new forms of modern communication and transportation that whatever the historical connection between the value of the land assets and the initial "start up" operations of the grantee company, the purposes of the granting legislation have been accomplished. Hence a corporate restructuring of the company's assets that separates the value of the land grant lands from the operational expenses of the railroad operations would not violate any express or implied terms of the grants.

It must further be asked whether Congress intended to sustain the operation only of the lines described in the legislation, or whether, since one of the primary purposes of the legislation was the settling and commerical development of the *area* served by the railroad, the grants were intended to sustain the "railroad purposes" of the company to which they were made.

If the former interpretation is correct, breach technically would not occur until the company sought abandonment of those lines specifically enumerated in the grants.

Under the latter interpretation arguably Congress did not intend to freeze forever any particular configuration of routes and branch lines, but rather to subsidize a rail *system* that as a minimum included the transcontinental line. This framework of analysis adopts a functional view of the land grants and obviates the need for either a precisely detailed retroactive interpretation of the original legislation or for a narrow interpretation as to which specific routes are linked to the grants. If the latter interpretation is adopted, then the breach or violation of condition occurs when the grantee company or its successor alienates the value of the land assets from supporting the operation of its railroad functions.

In any event, Congress has placed railroads under the jurisdiction of the Interstate Commerce Commission, and set standards for approval of abandonment and discontinuance of railroad lines and rail transportation [87/] without making exceptions of the land grant railroads. It still could be argued that the obligations of Burlington Northern under the land grants are to be read in addition to any regulatory considerations imposed by the I.C.C., and that abandonment of certain lines is still a breach. Obviously, however, this is another area of ambiguity that Congress may wish to clarify if it desires additional factors to be considered with respect to the curtailment of the services of land grant railroads.

Congress may always amend earlier legislation — a fact that was expressly reiterated in section 20 of the 1864 Northern Pacific legislation where Congress reserved the right to amend the land grants to better accomplish the purposes of the act, including keeping the railroad in good working order.

It is clear, therefore, from the history and litigation of land grants that some action on the part of Congress may be necessary if it is determined that the present status of Burlington Northern and the land grant assets should be adjusted. Depending on what end result Congress feels desirable, it may interpret the original grants and clarify and set out remedies. Various alternatives are available.

Congress could, as was done in 1929, set out its concerns with respect to the present holding company structure of Burlington Northern and direct the Attorney General to bring suit to determine judicially if these company actions violate the terms and provisions of the land grants. This option asks the courts to resolve the statutory ambiguities and may simply serve as an intermediate step since the courts may seek further Congressional clarification as was done

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[87/] See 49 U.S.C. 10501 *et seq*. and 10903 *et seq*.

in the O. & C. case. Of course, a court could determine either that any obligation on the part of the railroad grantees had already been discharged, or that none existed, or that there is no breach until the company seeks to abandon one of the lines specified in the grants.

Congress also could set out its interpretation of the grants and events and pursue any of several other alternatives:

1) find that conditions of the land grants had been violated and revest title to some or all of the lands in the United States;

2) declare that the land grants were intended to subsidize the continued operation of the railroad and that any action on the part of the Burlington Northern that results in the segregation of the income of the land grant assets or their liquidated value from the operating expenses of the lines (or from the operating of the company's railroad functions in general) is unlawful, and provide time limits within which the company must make necessary adjustments; or

3) provide in some other way for a link between the income from the land assets or their liquidated value and the company's railroad functions, possibly by providing that certain percentages of such income or value must be shown by Burlington Northern as income and used in calculating their rates and demonstrating need for abandonment of various branches.

Obviously, this list is not exhaustive and even these possible alternatives must be researched further. The ultimate casting of the remedy depends on congressional concensus as to the nature of the problem and the proper interpretation of the granting language. When the background issues have been resolved, and the legislative goal determined, legal and economic experts may better conceive and refine viable solutions.

Pamela Baldwin
Legislative Attorney
American Law Division
October 19, 1981

Mr. **Creedy**. We support the positions of the various farm groups—I think there are six or eight of them—the Western Coal Traffic League; the North Dakota State Legislature took a position, on this investigation. We think it is crucial. We listened this morning to Mr. Baxter saying he was against that merger, and yet, it has gone through. We listened to the ICC saying well, they could look into the oversight bit, but they did not know whether they had any powers to do anything about it. We listened to the GAO saying that they have some problems. A Congressional investigation is the way in which you get at this thing, in my view.

I met Dick Grayson out in the hall, and he said that he wanted to point out to me that while applications are being made for preference share financing, which he is supporting, it was not to the BN but to the terminal company partially owned by the BN, so I am going to make that distinction.

Other than that, sir, we appreciate this opportunity to appear before you, and hope that this will lead to some resolution of these problems.

Senator **Baucus**. Thank you very much, John.

[The following was received for the record:]

Testimony of
John A. Creedy, President
Water Transport Association

My name is John A. Creedy and I am president of Water Transport Association of New York, a non-profit trade association of the leading ICC certificated and "for hire" water carriers operating on the inland rivers, the Great Lakes and in the coastwise and intercoastal trades.

We appreciate this opportunity to comment on new developments in national rail merger policy. The natural interest of the water carriers, of course, is the extent to which the reduction of the number of rail carriers and the growth of the economic power of those remaining will adversely affect rail-water competition and coordination. We are currently intervening in the huge UP-MP-WP merger to advocate that the ICC place a condition on the merger prohibiting abuse of the economic power of the merged entity to undermine rail-water competition and coordination.

In addition, WTA has placed before the ICC in this merger case the issue of determining the continuing responsibility of railroads to apply current income from land grant mineral and other assets to current rail operations both as to abandonments and the level of freight rates, particularly freight rates on millions of tons of coal and grain connecting with the rivers and the Great Lakes.

We have also contributed comments to ICC proceedings under the Staggers Act to establish rail merger policy. In Ex Parte 282, Sub. 6, for example, decided Feb. 2, 1981, we raised the question of the transfer out of the railroad by land grant railroads of publicly provided assets. The ICC's comment on WTA's filing is worth quoting:

"WTA suggests that we add a section dealing with 'the problems stemming from the transfer by railroads to holding companies or noncarrier affiliates of assets without compensation or for an inadequate consideration.' Although we are aware of the potential for these problems, we do not believe that it is necessary or wise for us to examine each merger proposal to determine whether there have been holding company abuses. Where evidence of such abuses is offered, we will consider it in the disposition of that case. WTA's suggestion, that we consider imposing a condition requiring holding companies to return assets or proper consideration to their carriers, is one best considered in light of the particular facts of specific cases."

Thus ICC recognizes the problem, but says that the return of assets is one that is best considered in the light of particular facts of specific cases.

The ICC itself in an extensive report to Congress in 1977 on Rail Conglomerates raised the question of whether the transfer of the land grant assets out of the railroads to conglomerates and affiliates did not constitute a subversion of the intent of Congress in granting the lands in the first place.

The ICC's conclusion is well worth noting:

> "We are particularly concerned that lands which were granted by the Federal Government to railroads to enable them to fund the construction and operation of their rail lines -- or the proceeds from the transfer of those lands or of interests in those lands -- have been and will be transferred from the railroads to their parent holding companies at less than fair value. Were the railroads receiving these properties, or their railroad successors in interest, to be deprived of the fruits of these land grants at a time, whether now or in the future, when they are needed to support rail services essential to the public interest, the intention of the Congress in making these grants would be subverted, and today's citizens would lose the benefit of the contract made by their forebears with the land-grant railroads."

The ICC promised to keep the Congress informed, but has done nothing in the way of follow-up in the intervening five years.

In the UP merger case, WTA has provided the ICC with an opportunity to exercise its powers to protect the public interest in the proper use of land grant assets in rail operations and, at the same time, implement the 1977 report. These billions on billions worth of Federal subsidies given, as the ICC found, for the "construction and operation of railroads" may have already been wrongly diverted from land grant railroads. In one case, that of the BN, a holding company has recently been set up having as one of its purposes the diversion of land grant assets from the railroad.

In the case of approval of the UP merger, the ICC has a unique opportunity to use its powers to preserve the overall public interest and to implement Congressional intent.

WTA first became interested in the land grant question as a result of the water carriers' search for a sound national transportation policy covering Federal aids to the various transport modes. While the extent of Federal aids to airways, highways and waterways are reasonably easily available, there had never been a reliable public accounting of aids to railroads.

WTA commissioned economic consultants to develop in-depth studies of the rail pension subsidies, the Federal capital grant program for the railroad industry, and the varied tax subsidies which the railroads alone have received, particularly from the Economic Recovery Tax Act of 1981. A major study was devoted to the rail land grants.

I am attaching a copy of the WTA-sponsored land grant study for the record as Exhibit I. In all the controversy that has developed over land grants since this study was published, the railroads have never successfully rebutted its facts. They have erupted with a heavily financed national advertising campaign re-asserting what they have always said, but the facts in the study stand.

Substantial questions remain unanswered as to the cornerstone of the railroad position that the land grants were repaid by rate concessions on government traffic. Once put under the microscope of professional study, the railroad position turns out to be no more than a piece of sophistry.

The much quoted Congressional study in 1944 which led to the ending of land grant rates after World War II proposed that the ending of the rate concessions should be a "two-way street" for the government with the railroads returning the remaining lands. The return of the remaining lands did not happen, of course.

The railroad reliance on a comparison of the value of the lands in 1870 with the value of the rate concessions provided mainly in World War II is a comparison of apples and oranges. As the study shows, if proper adjustments are made bridging the time gap, the value of the lands at the time the rate concessions were made had to be four to five times the value of the rate concessions. The rail arithmetic for the celebrated payback is a fiction.

The rate concessions were provided in World War II mainly by non-land grant eastern railroads.

The railroads themselves argued in 1946 that ending the land grant rate reductions would result in lower rates on commercial traffic, thus establishing that rate reductions on government traffic had, in fact, been passed on to the commercial shippers all along, so for this reason alone, the celebrated "payback" is an illusion.

The largest beneficiary of land grant wealth of all, the Union Pacific, was, in fact, exempted by statute from any requirement to offer reduced rates on government traffic in return for the land grants. Section 6 of the 1862 Land Grant Act, applying to the Union Pacific, expressly provided that transportation for the government be "at fair and reasonable rates of compensation, not to exceed the amounts paid by private parties for the same kind of service."

One of the most interesting revelations of the WTA-sponsored study of land grants is the extent to which Congress has sought and failed to obtain elementary information on the current value of the remaining grant lands and the current income from the lands and reserved mineral rights. There is a long history of attempts by Congress through the Interior Department, the Department of Transportation, and the ICC to obtain current information on the value of the government-provided lands -- and a concerted effort by the land grant railroads to frustrate the natural Congressional desire for such information.

Probably the most detailed information that has ever been obtained on the value of current assets of a land grant railroad resulted from the cross-examination by WTA's attorney of the chief executive and financial officers of the UP during the current merger hearings. I attach, as Exhibit II, a summary of the extensive holdings of all the land grant railroads, including those of UP, in coal, oil and gas, timber lands, trona, uranium, and agricultural lands. "Billions on billions" in assets is far from an overstatement.

Some flavor of the enormous value of these assets comes from testimony in the hearings by Ben Biaggini, president of the Southern Pacific, who has some land grant holdings of his own, but is alarmed as a competitor by the overwhelming economic power represented by the UP's land grant assets. The UP, he says, "has been enriched beyond belief by the land grants."

WTA was severely handicapped in its attempt to develop a full picture as to UP by the arbitrary limitations placed on cross-examination by the ICC's Administrative Law Judge Paul S. Cross, limitations which have been formally protested to the full Commission and may form the basis for future legal action.

I would like to make it clear that WTA is not, at this time, challenging the right of the railroads to continue holding the government-provided lands and the mineral rights derived therefrom even though many of the land grant railroads appear to have broken their basic covenant with the government by transferring the land grant resources out of the railroads to conglomerates and affiliates without proper, or, indeed any compensation to the railroads and may thus have forfeited their right to continue to hold the lands.

We are not stressing the frauds that have occurred in the disposal of these lands, though a couple of farmers in Arizona recently won a jury award of $21 million dollars on the basis of a fraud allegation against a land grant railroad. This law suit may well open up questions on a propriety of the behavior of all the land grant railroads.

We note in passing that an earlier Congressional attempt to obtain facts on the land grants was met by a Southern Pacific response that, in any such enquiry, the Southern Pacific would have to take the Fifth Amendment. That sounds interesting, but no one has yet asked what the SP means by such a comment.

We are interested in helping to create a sound and consistent national policy on government subsidies. We are interested in moderating rail rates between the vast western resources and connecting barge services on the Mississippi by the Columbia- Snake System and the Great Lakes.

In its 1977 report, the ICC found that there is a major public policy issue on whether the intent of Congress in making these grants has been subverted and today's citizens may lose the benefit of the contract made by their forebears with the land grant railroads. The logic of counting land grant income provided expressly for railroad purposes as a subsidy to be passed on to the public in some form is irresistible.

The government provides hydroelectric dams on the Columbia River and electricity rates resulting from these were among lowest in the country because of the subsidy. Rates for city commuters are lower than they would otherwise be because they benefit from mass transit aid and rates of rural electric co-ops are lower than they would otherwise be because of benefit from government financing aids. The idea has been taken up in correspondence within the ICC by a number of powerful committee chairmen in Congress, John Dingell of Michigan, Chairman of the Railroad Oversight Committee; and John Seiberling of Ohio, Chairman of the Public Lands Subcommittee. On the Senate side, the present chairman has had a number of useful exchanges with the ICC on the subject.

Why should land grant subsidies be treated so differently? It may well be argued that oil and gas should not be required to subsidize transportation and ordinarily that makes sense. But oil and gas and other wealth provided by the government for railroad purposes is a very different matter. What obligation, if any, does a land grant railroad have to use its government-provided riches to sustain essential rail operations?

Currently, the Federal government, or state governments, or local communities or shippers are being asked and expected to subsidize and are subsidizing essential services which do not meet the profit goals of the land grant railroads, profit goals set as a result of complete "market dominance" or monopoly in many cases. Where subsidy fails, essential trackage is being abandoned. In the background, of course, is the possibility that a land grant railroad itself may one day fail to meet the profit goals of a holding company formed to exploit the government-provided riches. What claim then would or should the government and the public have on these resources to insure the continued operation of the railroad itself? This is the public policy issue which needs Congressional investigation and action.

As you will hear separately, every one of the major national farm organizations is supporting a Congressional investigation of railroad land grants to try to resolve the question of why land grant subsidies should not be treated like any other subsidy. In addition, the Western Coal Traffic League has passed a resolution supporting a Congressional investigation of railroad land grants as have a number of other groups.

Of course the railroads have not only successfully re-written history, but have relied on a series of legal technicalities to obscure the basic issue.

This basic issue was nowhere more succinctly stated than by Robert Kadrmas, president of the North Dakota Farm Bureau Federation, in testimony before the North Dakota State Tax Commissioner, Kent Conrad, on October 1, 1981. Mr. Kadrmas said: "I live in the Dickinson area and in western North Dakota many members refer to the arrogance of the Burlington Northern on the one hand abandoning rail lines -- the lifelines of many communities in North Dakota -- while sapping the state of mineral resources from lands given to them with the understanding that those resources be put back into the maintenance of the rails.

"A blatant case in point is the branch line between Watford City and Fairview and Fairview to Sidney. Lands given free and clear to Burlington Northern to place and maintain those rail lines has produced one of the richest oil finds in North Dakota. Just south of Arnegard on the Red Wing Creek field, eight Burlington Northern wells have been pumping approximately 6,000,000 barrels for seven to eight years. Three of the eight have produced over 1,000,000 barrels.

"While the wells have been thriving, the rails have been deteriorating. Although these rail lines may not be on this year's Burlington Northern abandonment design plan, they are being allowed to deterioriate so that the next round the questionable statistics will bear out Burlington Northern's cost effective abandonment-rationale.

"North Dakota has become the dog being wagged by the Burlington Northern tail. It's one thing to swallow abandonments based on profit-progress rationale, but somehow the profit gained from free rights to North Dakota minerals could allow most branch lines to remain functional plus subsidizing subterminal development.

"We have become victims of a myth perpetuated to make us believe that the rails are doing us a favor. They are reaping profits of the investment of our ancestors while denying a rightful legacy to our children."

There is a need to cut through all the technicalities and the railroad smokescreen. It would seem to be a proper job for Congress.

Last October, the Congressional Research Service of the Library of Congress published: "A Legal Analysis of the Land Grants of the Northern Pacific Railroad" -- the land grants which are now part of the Burlington Northern's assets.

The study concluded on page CRS 40 that the Congress could:

" 1) find that conditions of the land grants had been violated and revest title to some or all of the lands in the United States;

" 2) declare that the land grants were intended to subsidize the continued operation of the railroad and that any action on the part of the Burlington Northern that results in the segregation of the income of the land grant assets or their liquidated value from the operating expenses of the lines (or from the operating of the company's railroad functions in general) is unlawful, and provide time limits within which the company must make necessary adjustments; or

" 3) provide in some other way for a link between the income from the land assets or their liquidated value and the company's railroad functions, possibly by providing that certain percentages of such income or value must be shown by Burlington Northern as income and used in calculating their rates and demonstrating need for abandonment of various branches."

In conclusion, let me say that WTA supports the positions of the various farm groups, the Western Coal Traffic League, the North Dakota State Legislature, and others in seeking a Congressional investigation of the railroad land grants to:

-- establish the value of and income from the government-provided lands and mineral rights currently held.

-- determine what obligation, if any, a land grant railroad has to use assets provided by the government for railroad purposes to sustain essential current railroad operation.

-- determine what right, if any, the land grant railroads have to divert land grant assets and income therefrom from operations of railroads.

-- determine what authority the ICC should have to control abuses involving land grant assets.

-- examine the use of holding companies to avoid review of security transactions and to reduce apparent rail income.

-- examine the extent to which current income from land grants should be counted in determining adequacy of revenues and earnings and the extent to which abandonments in the west should be permitted on land grant railroads.

Beyond issues of national rail merger policy, there looms the question of how to finance government aids of various kinds to the different transport modes. A policy of cost recovery has been proposed and is in place for airways, highways, and waterways. Railroads are the conspicuous exception.

Clearly the land grant subsidies must be counted in any comparison of subsidies among the various modes. Taxing land grant railroads to recover these vast amounts may not be appropriate, except perhaps that royalties might be assessed on the mineral resources to provide a return flow to the government of at least some of what Mr. Biaggini calls the "unbelievable riches" to defray current railroad subsidies. Return of the lands to the government is not an issue at present. But return of the lands to the railroads and a prohibition against transfer of the assets out of the railroads in the future seems a modest and sensible middle course as a way to strengthen the western railroad systems and significantly contribute to the economic development of the west.

The question of using land grant income to avoid the necessity of calling on the Federal government for financial aid was brought into sharp focus on March 15 in the testimony of Mr. Richard C. Grayson, president of the Burlington Northern, before the Surface Transportation Subcommittee of the Senate Committee of Commerce, Science and Transportation. Mr. Grayson urged the continuation of programs of Federal aids to railroads and announced that BN -- a major land grant railroad -- planned to apply for $60 to $80 million dollars in preference share financing for its proposed St. Louis Gateway project.

There is little question that the objectives Mr. Grayson recites for the project -- to improve railroad operational efficiency, to provide opportunities for economic development and to reduce railroad community conflicts -- have often provided the rationale for public investment.

Federal financial aid in the form of preference shares may involve, as it has in other cases, the deferment of interest and repayment of principal for 10 years and an overall interest rate of 2 per cent. This is, by any definition, a very substantial Federal subsidy.

It is inconsistent of the BN on the one hand to resist cost recovery of this Federal subsidy, while insisting that there be cost recovery for Federal subsidies to barge lines. It is particularly ironic for a land grant railroad, currently earning large amounts of income from assets provided by the government for railroad purposes to apply for such Federal aid at all. The Congress might well take the view that it had provided, and more than provided, for any foreseeable financial needs of the BN with the land grants. It renders urgent the need to determine what obligation, if any, a land grant railroad has to use its government-provided assets to sustain its rail operations.

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EXHIBIT II

A PARTIAL LISTING OF RESOURCES ON REMAINING LAND GRANTS PROVIDED BY THE GOVERNMENT FOR RAILROAD PURPOSES

( )TE: Railroads have consistently refused to provide Congress with a current accounting of the value of remaining grant lands and mineral rights. Sources of the following data as to Union Pacific were developed from the UP merger hearings before the ICC. Other data comes from a variety of published reports, presentations to security analysts and railroad financial consultants.)

UNION PACIFIC

- 1 million acres of grant lands still retained
- 7.5 million acres on which mineral rights are retained
- 25 billion tons of trona, from which soda ash is derived
- $2.7 billion, present value of oil and gas reserves. Future net revenues from oil and gas already developed $450 million a year
- 15 billion tons of coal reserves

BURLINGTON NORTHERN

- 2.4 million acres of land of which 1.5 million acres are in timberlands in the west
- 6 million acres on which mineral rights are retained
- 15 billion tons of coal economically mineable
- 50 billion tons of coal reserves

SOUTHERN PACIFIC

- 3.8 million acres of land owned
- 1.2 million acres on which mineral rights are retained

SANTA FE

- 4.2 million acres on which mineral rights are retained
- 600 million tons of coal reserves
- $1.6 billion in royalty payments committed to Santa Fe under existing agreements covering coal contracts over next 46 years

Senator **Baucus**. I am curious whether you, Paul, or others, particularly from the agricultural point of view, have noticed any signs of failure of the BN to maintain its operation—the old maintenance question—are there any signals or any signs that any of you, from the agricultural point of view, might notice? Some of the rail employees mentioned this, and I am curious whether that is something you could confirm or not.

Mr. **Leuthold**. Well, I guess on the main lines, they certainly appear to be maintaining those, but they are deliberately not maintaining some of the branch lines.

Mr. **Sacia**. There are a lot of concerns about abandonment, but probably the most emphasis is on rail rate fluctuations, in the States of Montana and Idaho.

Senator **Baucus**. I am curious, though, is there sort of de facto abandonment in the sense of inadequate maintenance in some of the branch lines—I would just throw that out. I am not saying that it is happening; I am just curious whether in your view you are noticing any maintenance deterioration of any kind, like less power, for example, or maintaining less frequently, anything that you might be aware of.

Mr. **Leuthold**. Well, the particular line that I am on, they are scheduled to abandon, or they are going to request it. It all started back when the boxcar shortage started, and they did not bring us any boxcars, so the elevators did not get any boxcars, so then the railroads said, "Well, you have not been shipping any wheat, so we have lowered you on the list. We cannot bring you any boxcars, since you are down lower on the list." And now they have gone to 100-ton hopper cars and they say the line is too light to run the cars on. Then, to further put the demise on it, they have literally discriminated against rates. And grain is going to flow to the lowest rate. And what is happening through the abandonment, instead of me hauling my grain 3½ miles, I now have a choice to haul it 30 miles. That is what is happening all over Montana. So we are looking at farmers buying their own trucks to haul it 20 or 30 miles, and we are looking at deterioration in the highway system.

Senator **Baucus**. What does that do to your profit margin when you have got to haul longer distances?

Mr. **Leuthold**. Well, it certainly takes it down. I will say, though, that the BN has put in 52-car unit rates, which has also helped bring the rate structure down.

Senator **Baucus**. I have talked to some farmers who tell me that it helps them if they are close to the terminals. But if you are far away from the terminals, it is not that helpful.

Mr. **Leuthold**. Well, the scramble we see going on now is, instead of having 150 to 200 grain elevators that you can deal with, I may have 3 or 4 grain elevators, and through the 52-car rate, we are going to end up with 5 or 6 major elevators in the entire State, or subterminals, that control everything. The fear that we see now is under the Staggers Act, the Burlington Northern also has the right to have secret contract rates. We assume that is coming next. But the elevators are even switching, they are swapping elevators, so they all own it in a certain area.

Senator Baucus. One of the fears that some people have about the holding company arrangement is that natural resources will no longer be used, because they will be competing, to help the rail operations, and as a consequence, the rail operations will go to various utility commissions and ask for rate increase or to abandon lines or to move to the kinds of contract rates that you are talking about. That is particularly worrisome because of the importance of freight rates not only to individual farmers, but also to the national economy—that is, that U.S. agricultural exports contribute about $25 billion to our balance of payments problem, and if freight rates go up, either through the kinds of problems we are talking about here, or waterway user fees, which are passed on to farmers as an additional cost of production and therefore less profitable, that that not only affects farmers, but also from a national security point of view, it tends to have an adverse effect upon our security, as well as our general economy. Do you agree with that? Is that a concern with you, too?

Mr. Leuthold. Yes, we would agree. I think once the 52-unit-car rate is in place, and subterminals are in place in Montana—which is happening much, much faster than anybody felt it was going to happen—that we are going to see rates that you never believed you would see.

Senator Baucus. I want thank you all very much. Bud, I want to particularly thank you, and Paul and John, we appreciate your coming.

That concludes our testimony today. I want again to thank very much all of the witnesses for their valuable presentations of testimony and the answers to questions that they have given to us. The hearing record will be kept open for 30 days to permit submission of additional written statements.

That concludes the hearing.

[Whereupon, at 2:45 p.m., the committee was adjourned.]

APPENDIX

Served March 4, 1982

F-9920

INTERSTATE COMMERCE COMMISSION

EX PARTE NO. 282 (SUB-NO. 3)[1]

RAILROAD CONSOLIDATION PROCEDURES

Decided February 19, 1982

The Commission adopts final rules governing informational requirements for carriers seeking authority for rail transactions brought under 49 U.S.C. 11343. These final rules amend 49 CFR Part 1111 and are set forth in the appendix to this decision.

DECISION

BY THE COMMISSION:

SUMMARY

We have decided to revise the informational requirements for rail carriers seeking authority for transactions governed by 49 U.S.C. 11343-11346. At the same time we are adopting rules incorporating the time limits of 49 U.S.C. 11345, as amended by section 228 of the Staggers Rail Act of 1980 (Staggers Act), Public Law 96-448. We have also made other changes necessitated by the Staggers Act. The revisions described below and set forth in the appendix will result in better use of Commission and carrier resources by reducing required information and avoiding lengthy and costly proceedings when unwarranted by their impact. Additionally, the submission of information that is unnecessary or available elsewhere will no longer be required.

BACKGROUND

In Ex Parte No. 282 (Sub-No. 3), we instituted a general rulemaking proceeding on our own motion by a notice published in the Federal Register on November 20, 1979 (44 F.R. 66626). There we proposed to revise our rail consolidation regulations, *Railroad Acquisition, Control, Merger, Consolidation Project, Trackage Rights and Lease Procedures,* 49 CFR Part 1111 (Consolidation Procedures), so that the information required in an application would vary in accordance with the significance of the transaction involved. Thus, we proposed to reduce the informational requirements for certain transactions defined as "minor," and categorically exempted from our regulation, under 49 U.S.C. 10505, certain additional transactions deemed of no regulatory significance. In addition, the proposed rules clarified the information required in all applications and the procedures for handling, prosecuting, and opposing a rail consolidation transaction.

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[1] This decision embraces Ex Parte No. 282 (Sub-No. 8), Railroad Consolidation Procedures—Time Revisions.

Upon receipt of the comments and reevaluation of the proposal, we issued final rules and exemptions generally adopting the procedural aspects of the proposed rules. *Railroad Consolidation Procedures*, 363 I.C.C. 200 (1980) (45 F.R. 62991, September 23, 1980). However, we determined that we should further modify and reduce the information required by our regulations, and proposed new rules containing these changes. *Id.*, see 45 F.R. 63012. The new proposal substantially reduced the data required to be submitted with an application, and announced that we would henceforth take notice of a number of specified official documents containing the same or similar information.

In addition, the proposed rules contained no reference to the traditional "traffic studies" which measure the likely extent to which a proposed transaction would divert traffic from competing carriers. These traffic studies, while generating useful information, had tended to focus the attention of the parties (and hence the Commission) more on issues of traffic diversion than on the impact of a transaction on competition or essential services. See *Railroad Consolidation Procedures*, 363 I.C.C. 784 (1981). Accordingly, the September 1980 proposal replaced the traditional "traffic study" with a requirement that applicants submit an "impact analysis" which not only indicated the potential diversion of traffic ("for the purpose of assessing the possibility that such [competing] carriers will be unable to provide essential services"), but also addressed the competitive impact of the merger. 363 I.C.C. at 214. The specific type of impact analysis was left "to the discretion of the party preparing the study." *Id.* at 215.

Only two comments were submitted in reponse to this proposal: by the Association of American Railroads (AAR) and Consolidated Rail Corporation (Conrail). Our processing of this proposal was, however, significantly delayed for two reasons.

First, in section 228 of the Staggers Act, Congress significantly changed the law governing our processing and determination of rail consolidation transactions. To deal with the most immediate of these amendments—the expedited statutory deadlines applicable to transactions other than the "merger or control of two or more class I railroads"—we published interim rules on November 10, 1981 (45 F.R. 74488). Comments to these interim rules were filed on December 10, 1981 by Patrick

W. Simmons, Illinois Legislative Director for the United Transportation Union (UTU). Further, because the Staggers Act changed the basis upon which we consider certain types of rail consolidation transactions, we have also reviewed our proposal to determine what changes in our informational regulations are necessary. And, as required by the Staggers Act and recent court decisions, we have supplemented the provisions governing exempted transactions to clarify that the participating carriers remain subject to the statutory obligation to protect the interests of employees.[2]

Second, in using the newly adopted procedural regulations, we have discovered several problems which we have sought to correct to the extent possible in this proceeding.

After considering the comments, the statutory provisions and our own experience with the regulations, we have decided to adopt the rules proposed (1) in Ex Parte No. 282 (Sub-No. 3) with minor amendments suggested by the comments and as necessary to comply with the Staggers Act and recent court decisions, and (2) in Ex Parte No. 282 (Sub-No. 8) without substantive amendment.

Because the subject and issues involving the Consolidation Procedures were before the public, and because our changes are either required by the Staggers Act or without substantive effect to the rights of parties to consolidation proceedings, we believe our reevaluation and partial modification of the procedural regulations adopted in September 1980, the informational regulations proposed in September, 1980, and the interim regulations published in November 1980 can be made without notice and comment. *American Iron & Steel Inst.* v. *Envir. Prot. Agency*, 568 F. 2d. 284, 293 (3d Cir., 1977).

DISCUSSION

We will discuss changes to our September 23, 1980 adopted and proposed Consolidation Procedures *seriatum*.

Before discussing the comments, a brief overview of the format of the Consolidation Procedures is provided. The Consolidation Procedures consist of two subparts. Subpart A deals generally with transactions by rail carriers under 49 U.S.C. 11343. Subpart B (which is unchanged in this proceeding) governs the acquisition of lines of bankrupt railroads under either the *Milwaukee Railroad Restructuring Act, Pub. L.*, No. 96-101 (1979), or 11 U.S.C. 1172.

Within subpart A, sections 1111.0-1111.4 contain a declaration of scope and purpose, our general policy statement, types of transactions, definitions, and procedures, respectively. The informational requirements for an application are found in sections 1111.6 to 1111.9. They require general supporting information, market analyses, operational data, and financial information, respectively.

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[2] These actions are taken pursuant to court remand of the appeal by various labor interests from our decision promulgating new procedural rules. See *Simmons* v. *I.C.C.*, No. 80-2577 (D.C. Cir. October 22, 1981).

Scope and purpose.—The "expedited rail carrier procedure" provided in 49 U.S.C. 11346 carried a statutory expiration date of January 1, 1982. Accordingly, all references to this section in the rules (including the term "coordination project") have been eliminated.

General policy statement.—The policy statement in these regulations (section 1111.1) is that adopted in *Railroad Consolidation Procedures*, 363 I.C.C. 784 (1981). No change has been made in this proceeding.

Types of transactions.—The procedural regulations promulgated in September 1980 classify all rail consolidation transactions into three categories (section 1111.5) and adjust the information required of an applicant depending upon its classification (section 1111.2(b) and (c)). A transaction is "major" if it (1) involves a class I railroad and at least one other class I or class II railroad, and (2) is either a "merger or control" or a lesser transaction which constitutes a "major market extension." A transaction is "exempt" under our rules if it falls into any of the six narrow categories listed in section 1111.5(c). Finally, a transaction is "minor" if it is neither "major" nor "exempt."

The Staggers Act, however, created its own classification of transactions, on which depend both the statutory deadline and the substantive criteria applicable to our decisions. Under current law a "merger or control of 2 or more class I railroads" must be decided within 31 months under traditional public interest criteria, 49 U.S.C. 11344(b),(c) and 11345(b). Other transactions "of regional or national transportation significance" must be decided within 10 months under the restricted competitive criteria of new 49 U.S.C. 11344(d)[3]; and other transactions which are *not* of regional or national transportation significance must be decided within 6 months, also under the restricted competitive criteria of 49 U.S.C. 11344(d).

In Ex Parte No. 282 (Sub-No. 8), we proposed to combine the separate classification systems of the statute and our regulations into one four-part system. The definition of a "major" transaction in our regulations was retained, and all "major" transactions were presumed to be of regional or national transportation significance. The "major" classification was then divided into two parts: transactions involving the merger or control of two or more class I railroads, and other transactions of regional or national transportation significance.[4] All "minor" transactions under our regulations were presumed not to be of regional or national transportation significance; the "exempt" classification was unaffected.

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[3] We first construed section 11344(d) in *Norfolk & Western Ry. Co.—Pur.—Illinois Term. R. Co.*, 363 I.C.C. 882 (1981).

After further analysis, we have decided to retain this basic four-part classification, but to relabel the "major" classification for clarity and ease of reference. Under the regulations adopted here, a "major" transaction refers only to the merger or control of two or more class I railroads. Other transactions which involve at least one class I carrier acting together with a class II or class I carrier, in a major market extension have been relabelled "significant" transactions.

Exempt transactions.—Slight modifications are necessary to reflect the amendments made to 49 U.S.C. 10505, our exemption authority, by the Staggers Act. First, the criteria for the issuance of exemptions are now less restrictive; section 1111.2(d) has been amended to indicate the new criteria. Second, we no longer have the authority to exempt a transaction from statutory labor protection obligations; accordingly, the Consolidation Procedures have been amended to indicate that employee protection must be provided if it would have been required if the transaction were not exempt. (Section 1111.2(d) and 4(g)(2) and (3).)[5]

The level of protection required will be the statutorily prescribed level unless a higher level of protection is demonstrated to be necessary. In some cases, this minimum protection may require a carrier to negotiate a final agreement with employees before consummation of the transaction.[6] We do not consider this condition to be inconsistent with the procedure in our final regulations requiring a carrier to file a verified notice of an exempt transaction before the transaction is consummated. However, in order to give carriers more flexibility in those transactions in which a final labor agreement must be negotiated before consummation, we have modified our rules to require that carriers notify us of an exempt transaction at least 1 week prior to consummation, rather than 1 to 3 weeks prior to that event (see section 1111.4(g)(1)). By removing the 3-week maximum period between filing and consummation, we are giving carriers two options with respect to their preconsummation labor negotiations. A carrier may either reach a final agreement with labor before filing its notice with the Commission, or it can file a notice with us and then secure a final agreement with labor. In the latter case, although the carrier had filed its notice with the Commission, it still would be prohibited from consummation until after negotiation of the final labor agreement.

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[4] Specifically, we defined transactions of regional or national transportation significance to be (a) controls or mergers which do not involve two or more class I railroads and (b) transactions involving major market extensions. See proposed sections 1111.5(a)(2) and (3). Upon further reflection, we have determined that only transactions involving major market extensions are of regional or national transportation significance. *Norfolk & Western Railway Co.—Purchase—Illinois Terminal Railway Co.*, (not printed), served January 21, 1981 (46 F.R. 6036 at 6037).

[5] This amendment also reflects the Commission's further consideration of *Simmons* v. *Interstate Commerce Commission*, No. 80-2577 (D.C. Cir. filed December 29, 1980). The petitioner in that case challenged the failure of our current rules to require labor protection in exempted transactions. In a recent decision, *McGinness* v. *Interstate Commerce Commission*, No. 79-2457 (D.C. Cir. August 17, 1981), the court had found that the Staggers Act prohibited the Commission from granting exemptions from labor protection obligations. In light of that opinion, we decided on October 9, 1981 to seek remand in the *Simmons* case, and to add to our rules the caveat that exemptions do not relieve participants of their statutory obligation to provide labor protection. The court authorized the remand on October 22, 1981.

[6] See *New York Dock Ry.—Control—Brooklyn Eastern Dist.*, 360 I.C.C. 60 (1979), affirmed *New York Dock Ry.* v. *United States*, 609 F. 2d 83 (2d Cir. 1979).

In its comments, Conrail expressed concern that our enumeration of specific categories of transactions that we have exempted by regulation, coupled with our prohibition against seeking a waiver of all regulations (section 1111.4(f)(1)), might preclude a carrier from petitioning for exemption of a transaction other than one within the "exempt" categories of section 1111.2(d). Conrail's concern is unwarranted. It is possible that Conrail has confused the concepts of waiver and exemption.

The exemption is a statutory procedure under which we are charged to determine, pursuant to section 10505, whether our regulation of a transaction under the Interstate Commerce Act is necessary. If we find it is not—as we have for the six general categories listed in the Consolidation Procedures—then we do not scrutinize the transaction under the Interstate Commerce Act. (No application is filed.) Any person proposing a transaction meeting the statutory criteria of section 10505 may petition for an exemption; the class exemptions issued in these regulations do not limit that right. See *Railroad Consolidation Procedures*, 363 I.C.C. 200, 205 (1980).

In contrast, a petition for waiver is directed to the requirements of our regulations for applications filed under the Interstate Commerce Act. We have encouraged parties to use the waiver process so that applications can be tailored to specific factual circumstances, and so that unnecessary and unavailable information need not be submitted with an application. The purpose of the waiver is essentially to reduce the burden on a proponent in preparing an application. Clearly, a waiver is unrelated to an exemption. They serve different functions and have different bases.

Definitions.—Conrail argues that we should expand our definition of types of transactions to include "consolidations." Our prior decision in *Railroad Consolidation Procedures*, *supra*, at 201-202, discussed this matter. If Conrail, or any other party, faces a situation which is not covered by the Consolidation Procedures it should file a petition for clarification.

In light of our experience in processing pending merger cases, we have modified the definitions of an applicant (section 1111.3(a)) so that information about the primary applicants (for example, as transferor of trackage rights) need not be provided in a responsive application. A responsive applicant has access to the data required of a primary applicant only through discovery procedures. Moreover, to the extent information about a primary applicant would normally be required in a responsive application, much of the information will already be contained in the primary application. We can require the primary applicant to furnish additional information should it prove necessary in particular cases.

Also in light of our experience in using the procedural regulations to process pending cases, we are adding four new definitions. The petition for clarification (section 1111.3(d)) and the petition for waiver (section 1111.3(e)) are defined to clarify the prefiling relief parties may seek. Also, we have moved the definition of a primary applicant from section 1111.4(c)(1) to section 1111.3(b), and the definition of responsive applicants from section 1111.4(d)(4) to section 1111.3(h).

Finally, we have deleted the first sentence of section 1111.3(c) to clarify the meaning of "major market extension." This sentence has proved somewhat confusing and is unnecessary in light of the detailed description in the remainder of the subsection.

Service list.—Our procedural regulations provide for the Commission to prepare and issue the list of parties 55 days after an application is accepted.[7] However, the new Staggers Act deadlines make this 55-day period unacceptably long for "significant" and "minor" cases. Accordingly, we will issue the service list in these cases 45 days after an application is accepted. Section 1111.4(a)(4) has been so changed.

Prefiling notice.—Conrail contends, again, that a prefiling notice (section 1111.4(b)) unduly extends the time it takes to process a case and thus contravenes congressional policy. As we have previously said, *id.* at 207, the prefiling notice benefits all parties. We firmly believe that a proceeding can be expedited if all potential parties have advance warning and are able to define their positions and develop their evidence. Since the notice will presumably be filed while the application is being prepared, we do not believe our prefiling notice requirement will cause any delay in the processing of rail consolidation transactions.[8]

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[7] The purpose of this service list is to identify the parties upon whom service of comments and pleadings by other parties is required. Accordingly, we have amended our regulations to show that persons indicating an interest in the proceeding, but not wishing to become parties, will not be included on this service list. However, the Commission will provide them with copies of all decisions and orders issued by the Commission.

[8] In particular cases, where the full prefiling notice period might delay the proceeding and adequate notice of the proposed transaction has been given by the media, we have granted a waiver of the prefiling period. See, *e.g.*, Finance Docket No. 29720, *Guilford Transportation Industries, Inc.—Control—Boston & Maine Corp.* (not printed), served September 11, 1981.

We are requiring a prefiling notice for significant transactions because of their regional and national transportation significance as well as the short time in which we must decide them. We are also subjecting significant transactions to the same procedural and informational requirements as major transactions in sections 1111.4(c)(2)(iv), (c)(3), (c)(5)(i)(E), (d)(1)(iii)(H) and (I), (d)(2), 1111.6(b), 1111.7, 1111.8(a) and 1111.9. However, in light of the limited criteria under which we must render our decision in "significant" cases, and of Congress' clear intent that we expedite these cases, we have reduced the prefiling period in "significant" cases to 2-4 months (versus the 3-6 months applicable to "major" cases).

Incorporation by reference.—Our procedural regulations permit applicants to incorporate information from other documents by reference in the application, provided the information is up-to-date and applicant is prepared to supply copies of this information to interested parties on specific request. Section 1111.4(c)(2)(iv). Because documents are now retained by the Commission for only a limited period of time, we have modified this provision to assure the availability of information incorporated by reference. The regulations are amended to allow incorporation by reference to documents only if the documents were filed with the Commission within 3 years prior to filing of the application.

Additional information.—AAR supports our reservation, in section 1111.4(b)(2)(v), of the right to request additional information in an application. AAR believes that this will help to focus on data and issues which are highly relevant. However, AAR wants us to reject any application as incomplete if it does not contain the additional information requested.

We believe that it is better to retain some flexibility than to set a rigid rule which would require the rejection of an application. There may not always be sufficient lead time for the preparation of this information between the time we request it and the time the applicant must file its application. If there is sufficient time to prepare the information and it is not included in an application, we can reject the application as incomplete. However, these situations are best addressed on an individual basis.

Direct testimony.—Conrail renews its objection to filing direct testimony concurrently with major, significant, or responsive applications (section 1111.4(c)(3)). We dealt with this issue in our September 1980 decision and have not changed our view. Submission of direct testimony with the application speeds the proceeding, improves the quality of cross-examination (if needed) and the evidence adduced, reduces regulatory lag, and requires the applicant to present its case with the initial filing of its application. *Id.* at 208. It also helps us decide if a prima facie case has been made. We will not change the requirement.

Prima facie case.—AAR requests that we explain our requirement that an application present a prima facie case. (Section 1111.4(c)(8).) In a recent decision, Ex Parte No. 282 (Sub-No. 3A), *Railroad Consolidation Procedures,* 363 I.C.C. 767 (1980), 45 F.R. 84803 (December 23, 1981) we explained how the Consolidation Procedures would allow us to expedite the processing of consolidation applications. We indicated that:

> Applicants can fail to meet their burden of proof either by (1) disclosing facts that, even if construed in their most favorable light, are insufficient to support a finding that the proposal is consistent with the public interest, or by (2) disclosing facts that affirmatively demonstrate that the proposal is not in the public interest. *Id.* at 769.

We further stated that:

> If the information contained in an application will not support findings on each of the statutory elements (and any additional elements required by court [or] our precedent) and will not support a conclusion that the proposal is consistent with the public interest, then summary denial is an appropriate disposition of the proceeding. *Id.* at 770.

Our use of the prima facie case has been clearly explained. However, we will make this information more readily available by quoting a portion of the language and citing to Ex Parte No. 282 (Sub-No. 3A) in the Consolidation Procedures.

Need for oral hearing.—In deciding whether to hold an oral hearing on a case, we must be apprised of the disputed material facts that can only be resolved at a hearing. Hence, in addition to a request for oral hearing, we will require this information in the comments (section 1111.4(d)(1)(iii)-(E)).

Inconsistent applications.—UTU objects to our proposed amendment to section 1111.4(d)(4) which would not permit filing inconsistent applications or applications for inclusion in "minor" transactions.

The Staggers Act amended 49 U.S.C. 11345 to provide separate procedural schedules for different types of consolidation transactions, with specific, varying deadlines for acceptance of an application, for the filing of comments by the public and by the Departments of Justice and Transportation, for the conclusion of evidentiary proceedings, and for preparation of a final decision. In addition, Congress specified that, for "major" transactions, inconsistent applications and applications for inclusion must be filed 90 days after acceptance of the initial application, and that, for "significant" cases, inconsistent applications and applications for inclusion are required to be filed 60 days after acceptance of the primary application. The statute makes no mention of, and provides no procedural schedule for, inconsistent applications or applications for inclusion in "minor" transactions. As we stated in our notice, we presume that this omission was intentional and that Congress did not contemplate the filing of inconsistent applications or petitions for inclusion in "minor" cases. Moreover, section 11345(d), as amended, provides only 105 days from acceptance (60 days from the submission of comments by DOT and DOJ) for conclusion of the evidentiary stage of a minor proceeding. As a practical matter, we could not normally accept an inconsistent application, publish it for comment, and complete an evidentiary proceeding within this time period. Consequently, we decline to amend our Consolidation Procedures as requested by UTU.

Technical changes.—We have reformatted sections 1111.4(d)(4) and 1111.4(e) solely for ease of understanding. We have also eliminated section 1111.4(d)(5) consistent with the deletion of the traffic study requirement (discussed below) and with our decision in this proceeding served November 24, 1980.[9] Conrail supports elimination of this section.

Waiver procedures.—Our procedural regulations provide that a waiver or clarification granted to any applicant in a proceeding shall apply "to any other applicants filing directly related applications or responsive applications." Section 1111.4(f)(4). By its terms, the waiver would not apply to an active party to a proceeding who had nonetheless not filed a directly related or responsive application.

Although most waivers relate to informational requirements for primary and responsive applications, and hence are relevant only for parties preparing applications, some more general requirements applicable to all parties to a proceeding (such as procedural deadlines) can be the subject of a waiver request. Such waivers should apply to all parties, whether or not they file a responsive application, unless the waiver indicates otherwise. See F.D. No. 30000, *Union Pacific Corp.—Control—Missouri Pacific Corp., Decision on Petitions for Waiver or Clarification of Various Regulations* (not printed), served December 23, 1980. The regulations are amended accordingly.

Official notice.—In section 1111.4(h) of our proposed regulations, we indicated that we would take official notice of a number of documents compiled in the ordinary course of business and submitted as regular reports. AAR believes that this material is highly relevant, reliable, and useful in railroad consolidation proceedings. It also indicates that parties generally stipulate to this type of information, while reserving the right to challenge the relevance and application of the data.

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[9] Our November 24, 1980 decision was issued in response to petitions filed in Finance Docket No. 30000, *Union Pacific Corp.—Control—Missouri Pacific Corp.* (applications accepted October 15, 1980).

Both AAR and Conrail note that many of the documents involved are not readily available to all parties, and request that applicants be required to make them available upon request. We believe their suggestion will fairly balance the applicant's reduced filing requirements with the right of interested persons for access to application information. We have therefore added an availability requirement to the Consolidation Procedures. (Section 1111.4(h).) Additionally, Conrail requests that advance notice be given of the material for which official notice will be requested by the applicants. This is also appropriate. We will require a statement in the application of the materials the parties request us to note officially. See section 1111.4(h).

Our purpose in proposing section 1111.4(h) was to reduce the information an applicant must file. This benefit should also extend to any party seeking relief in a rail consolidation. We will amend this section accordingly.

SUPPORTING INFORMATION

Designated operating officer.—Our proposed section 1111.6(a)(1)(i) would require an applicant to designate both its counsel and an "operating officer" to whom questions regarding the transaction may be addressed. Conrail opposes the requirement for designation of an operating officer, noting that an application is a legal pleading and that counsel for applicant should have the right in the first instance to determine both the necessity and the propriety of answering such questions and of determining who is best qualified to answer them. Conrail notes that the canons of professional ethics discourage communications between the attorney for one party to a controversy and the other party when the latter is represented by counsel.

Conrail's objection has merit and we will delete the operating officer requirement. However, the counsel designated by an applicant must be prepared to respond quickly and authoritatively to inquiries on traffic, sales, marketing, engineering or financial matters, even where the response must be obtained from operating officers.

Public interest justifications.—Our proposal to modify the informational regulations, issued prior to the effective date of the Staggers Act, did not take account of the act's amendments to the statutory standard for reviewing rail consolidation cases. Under the Staggers Act, the broad "public interest" standard which previously applied to all rail consolidations now applies only to "major" cases; the Staggers Act adopted a restricted standard for use in "significant" and "minor" cases. Thus, under 49 U.S.C. 11344(d), we are now required to approve "significant" and "minor" transactions unless we find that:

(1) as a result of the transaction, there is likely to be substantial lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region of the United States; and

(2) the anticompetitive effects of the transaction outweigh the public interest in meeting significant transportation needs.

Our proposed regulations did require an applicant in all cases to include a discussion of "the effects of the transaction on inter- and intramodal competitors, including a description of the relevant markets." Proposed section 1111.6(a)(2)(iv). However, in light of the increased—and frequently conclusive—importance of competition to our analysis of rail consolidations, we have moved this requirement to be the first of the public interest justifications required by our regulations. Further, we have expanded the subsection to request a specific discussion of "whether, as a result of the transaction, there is likely to be any lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region of the United States."

At AAR's request we have modified the language of section 1111.6(a)(2)(ii), requiring a discussion of "the financial consideration involved in the proposed transaction," by adding the more specific and descriptive language currently contained in section 1111.1(e)(1) of the Consolidation Procedures. Also for clarity, we have moved section 1111.6(a)(2)(v), exploring the effect of any increase in fixed charges, to follow immediately the discussion of the financial consideration. The remaining subsections in 1111.6(a)(2) have been redesignated.

Miscellaneous matters.—AAR also requests that we require the filing of exhibits 6, 7, and 9 which relate to Securities and Exchange Commission Forms 10K, S-14, and annual reports, respectively. AAR believes incorporation by reference of these documents would place a burden on parties interested in the proposal. We agree with AAR. These exhibits would normally be available only in Washington at the offices of the SEC, and it might not be easy for parties to obtain these documents in the short time periods required for participation in a consolidation proceeding. We will clarify the Consolidation Procedures to require that each of these exhibits be filed.

AAR has asked that we require more detailed information relating to intercompany relationships. We have done this by adding new exhibit 11 (section 1111.6(b)(6)), which requires a corporate chart as described in our November 20, 1979 notice of proposed rulemaking. We have also added two sections—1111.6 (b)(7 and 8)—requesting further information concerning corporate relationships.

Finally, to improve the comparability of environmental data submitted by various applicants in "major" or "significant" transactions, we have imposed a requirement that parties consult with the Commission's Energy & Environment Branch, prior to filing the notice of intent, on the format of data to be submitted (1111.6(a)(8)). In addition, we have specifically requested in each applicant's operating plan information on trainload and switching activity which would otherwise be included in the Environmental Report. (Section 1111.8(a)(1); compare 49 CFR 1108.7(c)(5)(i) and (ii).)

Impact analyses.—As noted above, one of the most significant aspects of our new proposed rules was its substitution of a market "impact analysis" for the traditional "traffic study" required in "major" and "significant" transactions. AAR generally supports this proposal. It suggests that the first sentence of the impact analyses requirement read: "In major transactions applicants shall submit analyses of the impact of the proposed transaction—both adverse and beneficial—on the applicants and other carriers affected by the proposed transaction."

AAR's statement focuses on only a part of the purpose of the market impact analysis—the impact on other carriers. However, a primary purpose of employing the impact analysis instead of the traditional traffic study is to sharpen our analysis of the impact of a proposed transaction upon competition and the provision of essential transportation services (rather than solely the impact upon the existing carriers providing those services).

Nonetheless, we agree with AAR that our regulations should include a statement clarifying the focus of a market "impact analysis." Accordingly, we have revised the first sentence of section 1111.7 as follows: "In major and significant transactions applicants shall submit analyses of the impact of the proposed transaction—both adverse and beneficial—on inter- and intramodal competition for freight surface transportation in the regions affected by the transaction and on the provision of essential services by applicants and other carriers."

Conrail opposes our "impact analysis" proposal and requests that we continue to require interchange data (current exhibit A-13), information regarding applicant's equipment fleet and volume of traffic (exhibit A-14), and a traffic study (exhibit A-15). Conrail opposes our proposal because it deems the information in exhibits A-13, -14, and -15 to be critical to an intelligent analysis of a merger, and fears that this information will be withheld from the record. We do not agree. These Consolidation Procedures provide for us to request certain material from an applicant in addition to that required by the Consolidation Procedures. (See section 1111.4(b)(2)(v).) Hence, we may well request evidence on the impact of the proposed transaction on a specific carrier or its gateways. Furthermore, certain of the information in the current exhibits will be obtained through the official notice of specific reports filed with the Commission. For example, information regarding equipment, the traffic handled, and interchange data can be officially noticed. We believe it appropriate to take official notice of specific reports, and not require preparation of several massive exhibits, to reduce the burden on parties proposing transactions.

Conrail is also concerned about impact analyses because applicants may not know what is required of them. In their view, "applicant should not have to guess what type of information, and how much, will be considered adequate." This fear, too, is misplaced. The type and content of impact analyses is left to the parties' discretion. An applicant is able to present relevant material in any form and by whatever means it chooses to advance its case. As long as applicants comply with the regulation and provide an impact analysis, we will not reject the application as incomplete. However, our acceptance of an application does not imply that the impact analysis supports approval of the transaction, just as our acceptance of an application under our prior regulations did not imply that the traffic study supported approval of the application. Applicants must always present a prima facie case in support of their proposal or face possible summary denial.

Finally, Conrail—joined on this issue by AAR—is concerned that consolidation proceedings will be greatly complicated by our general impact analysis requirement permitting each applicant to determine what data will be presented and in what form. AAR contends that traditional traffic studies will still likely be performed by applicants, but that these studies would not be comparable.

We believe that Conrail and AAR have overstated the effect of our impact analysis proposal on the comparability of data submitted in rail merger proceedings. First, we note that even under our prior regulations, parties retained a great deal of flexibility in choosing the assumptions to be used in developing traffic studies. The Commission only required that assumptions be reasonable and clearly stated, and frequently different parties used different assumptions. Second, the parties themselves have an interest in maintaining some comparability in the studies presented in a consolidation case, in order to criticize effectively the studies of other parties. Finally, we note that our regulations would permit us to assure the comparability of any traffic studies that may be submitted as a part of an impact analysis. The Consolidation Procedures contain a statement that "If appropriate, the Commission will also indicate the format of such analyses." (See section 1111.7.) This applies to traffic studies as well as other impact analyses. If a party chooses to prepare a traffic study, and needs guidance as to its preparation and format, the Commission will provide a format and methodology to follow. To obtain necessary guidance a party should file a petition with the Commission suggesting, and requesting that we approve, a traffic study format and methodology.

The rules governing submission of financial information (section 1111.9) provide for the incorporation by reference of balance sheets and income statements for current and past years. However, class I railroads may soon be the only carriers subject to these reporting requirements. (See 49 F.R. 9114, January 28, 1981, and 46 F.R. 25114, May 5, 1981.) We therefore will require class II and class III railroads, and noncarrier applicants, to submit balance sheets and income statements covering a period ending within 6 months before the application is filed.

Section 1111.9 also adds the requirement that financial statements for carriers conform to the Uniform System of Accounts, 49 CFR Part 1201. This revision will ensure that data filed in an affected transaction will be comparable to data on file with the Commission.

REGULATORY FLEXIBILITY ACT ASSESSMENT

Because this proceeding was instituted in July 1980, the Regulatory Flexibility Act is not applicable.

CONCLUSION

The regulations proposed with the amendments discussed here are adopted pursuant to 49 U.S.C. 11343-11347 and 5 U.S.C. 552 and 553. This is not a major action significantly affecting either the quality of the human environment or energy conservation.

Matters not specifically discussed here have been considered in reaching our ultimate decision in this proceeding.

The attached appendix is a compilation of our Consolidation Procedures. We have attached a complete appendix to this decision so that parties involved in railroad consolidations will have the entire text of the Consolidation Procedures in one place prior to their codification. These procedures will replace those currently in part 1111 of the Code of Federal Regulations.

Although this proceeding will now be terminated, we continually welcome suggestions that would help us eliminate material which is not needed to decide these cases.

COMMISSIONER CLAPP, dissenting in part:

While I support the continuing efforts to improve consolidation procedures and to less filing burdens where possible, I am concerned about the use of "market or impact analyses" in lieu of more specific filing requirements. An applicant should have the flexibility to provide only useful information but I believe that the Commission should offer more complete guidelines so that all interested persons will know what needs to be filed in an application. I am not necessarily advocating traffic studies although the AAR has pointed out traffic studies may still be necessary for analysis of impact on essential services. Whatever data is required generally, the waiver process is always available for relief when certain information is not needed or not pertinent.

Under the new regulations, the Commission may still be able to obtain the information needed to decide an application, but it will be by way of a less certain, more circuitous route. Thus, the burden on all parties may ultimately be greater.

It is ordered:

1. Part 1111 of title 49 of the Code of Federal Regulations is amended in conformance with the appendix to this decision.

2. This decision shall become effective 30 days from publication in the Federal Register.

3. Notice of this decision shall be given to the general public by depositing a copy in the Office of the Secretary of the Commission at Washington, DC and by filing a notice with the Director, Office of the Federal Register.

By the Commission, Chairman Taylor, Vice Chairman Gilliam, Commissioners Gresham and Clapp. Commissioner Clapp dissents in part with a separate expression.

AGATHA L. MERGENOVICH,
Secretary.

(SEAL)

APPENDIX

Subpart A of Part 1111 of Title 49 is revised to read as follows:

Part 1111—Railroad Acquisition, Control, Merger, Consolidation, Trackage Rights and Lease Procedures.

SUBPART A—GENERAL ACQUISITION PROCEDURES

Sec.
1111.0 Scope and purpose.
1111.1 General policy statement for merger or control of at least two class I railroads.
1111.2 Types of transactions.
1111.3 Definitions.
1111.4 Procedures.
1111.5 Reserved

Sec.—Continued
1111.6 Supporting information.
1111.7 Market analyses.
1111.8 Operational data.
1111.9 Financial information.
1111.10-19 Reserved.

(49 U.S.C. 11343-11347 AND 5 U.S.C. 552 AND 553)

SUBPART A

1111.0 *Scope and purpose.*

These regulations set out the information to be filed and the procedures to be followed in control, merger, acquisition, lease, trackage rights, and any other consolidation transaction involving more than one railroad that is initiated under 49 U.S.C. 11343. Section 1111.2 separates these transactions into four types: *major*, *significant*, *minor*, and *exempt*. The informational requirements for these types of transactions differ. Before an application is filed, the designation of type of transaction may be clarified or certain of the information required may be waived upon petition to the Commission. This procedure is explained in section 1111.4. The required contents of an application are set out in sections 1111.6 (general information supporting the transaction), 1111.7 (competitive and market information), 1111.8 (operational information) and 1111.9 (financial data). *Major* and *significant* applications must contain all of the information required in sections 1111.6 through 1111.9. The informational requirements for a *minor* application are more limited and are set out in sections 1111.6 and 1111.8.Procedures (including time limits, filing requirements, participation requirements, and other matters) are contained in section 1111.4. Index I lists all exhibits and indicates the type of application for which the exhibit is required. Index II is a table of contents of this subpart. All applicants must comply with the Commission's general procedural rules, in part 1100, unless otherwise specified.These regulations may be cited as the Railroad Consolidation Procedures.

1111.1 *General policy statement for merger or control of at least two class I railroads.*

(a) *General.* The Interstate Commerce Commission encourages private industry initiative that leads to the rationalization of the Nation's rail facilities and reduction of its excess capacity. One means of accomplishing these ends is rail consolidation. However, the Commission does not favor consolidations through the exercise of managerial and financial control if the controlling entity does not assume full responsibility for carrying out the controlled carrier's common carrier obligation to provide adequate service upon reasonable demand. Furthermore, the Commission does not favor consolidations that substantially reduce the transport alternatives available to shippers unless there are substantial and demonstrable benefits to the transaction that cannot be achieved in a less anticompetitive fashion. Our analysis of the competitive impacts of a consolidation is especially critical in light of the congressionally mandated commitment to give railroads greater freedom to price without regulatory interference.

(b) *Consolidation critera.* The Commission's consideration of the merger or control of at least two class I railroads is governed by the criteria prescribed in 49 U.S.C. 11344 and by the rail transportation policy set forth in 49 U.S.C. 10101a.

(1) Section 11344 directs the Commission to approve consolidations which are consistent with the public interest. In examining a proposed transaction, the Commission must consider, at a minimum: (i) the effect on the adequacy of transportation to the public; (ii) the effect of including, or failing to include, other rail carriers in the area involved in the

proposed transaction; (iii) the total fixed charges that would result; (iv) the interest of affected carrier employees; and (v) the effect on competition among rail carriers in the affected region.

(2) The Commission must also consider the impact of any transaction on the quality of the human environment and the conservation of energy resources.

(c) *Public interest considerations.* In determining whether a transaction is in the public interest, the Commission performs a balancing test. It weighs the potential benefits to applicants and the public against the potential harm to the public. The Commission will consider whether the benefits claimed by applicants could be realized by means other than the proposed consolidation that would result in less potential harm to the public.

(1) *Potential benefits.* Both the consolidated carrier and the public can benefit from a consolidation if the result is a financially sound competitor better able to provide adequate service on demand. This beneficial result can occur if the consolidated carrier is able to realize operating efficiencies and increased marketing opportunities. Since consolidations can lead to a reduction in redundant facilities and thereby to an increase in traffic density on underused lines, operating efficiencies may be realized. Furthermore, consolidations are the only feasible way for rail carriers to enter many new markets other than by contractual arrangement, such as for joint use of rail facilities or run-through trains. In some markets where there is sufficient existing rail capacity the construction of new rail line is prohibitively expensive and does not represent a feasible means of entry into the market.

(2) *Potential harm.* There are two potential results from consolidations which would ill serve the public—reduction of competition and harm to essential services. In analyzing these impacts, we must consider, but are not limited by, the policies embodied in antitrust laws.

(i) *Reduction of competition.* If two carriers serving the same market consolidate, the result would be the elimination of the competition between the two. Even if the consolidating carriers do not serve the same market, there may be a lessening of potential competition in other markets. While the reduction in the number of competitors serving a market is not in itself harmful, a lessening of competition resulting from the elimination of a competitor may be contrary to the public interest. The Commission recognizes that rail carriers face not only intramodal competition, but also intermodal competition from motor and water carriers. The Commission's competitive analysis depends on the relevant market(s). In some markets the Commission's focus will be on the preservation of effective intermodal competition, while in other markets (such as long-haul movements of bulk commodities) effective intramodal competition may also be important.

(ii) *Harm to essential service.* Consolidations often result in shifts of market patterns. Sometimes the carrier losing its share of the market may not be able to withstand the loss of traffic. In assessing the probable impacts, the Commission's concern is the preservation of essential services, not the survival of particular carriers. A service is essential if there is a sufficient public need for the service and adequate alternative transportation is not available.

(d) *Conditions.* The Commission has broad authority to impose conditions on consolidations, including those that might be useful in ameliorating potentially anticompetitive effects of a consolidation. However, the Commission recognizes that conditions may lessen the benefits of a consolidation to both the carrier and the public. Therefore, the Commission will not normally impose conditions on a consolidation to protect a carrier unless essential services are affected and the condition: (1) is shown to be related to the impact of the consolidation; (2) is designed to enable shippers to receive adequate service; (3) would not pose unreasonable operating or other problems for the consolidated carrier; and (4) would not frustrate the ability of the consolidated carrier to obtain the anticipated public benefits. Moreover, the Commission believes that indemnification is ordinarily not an appropriate remedy in consolidation proceedings. Indemnification conditions can be anticompetitive by requiring the consolidated carrier to subsidize carriers who are no longer able to compete efficiently in the marketplace.

(e) *Inclusion of other carriers.* The Commission will consider requiring inclusion of another carrier as a condition to approval only where there is no other reasonable alternative for providing essential services, the facilities fit operationally into the new system, and inclusion can be accomplished without endangering the operational or financial success of the new company.

(f) *Labor protection.* The Commission is required to provide applicants' employees affected by a consolidation with adequate protection. Similarly situated employees on the applicants' system should be given equal protection. Therefore, absent a negotiated agreement, the Commission will provide for protection at the level mandated by law (49 U.S.C. 11347), unless it can be shown that because of unusual circumstances more stringent protection is necessary to provide employees with a fair and equitable arrangement. The Commission will review negotiated agreements to assure fair and equitable treatment of affected employees.

(g) *Cumulative impacts and crossover effects.* The Commission recognizes that events can occur during its consideration of a consolidation that can have an effect on various of the concerned parties. However, the Commission is mindful of the need to meet its statutory deadlines and make timely administratively final decisions. Therefore, the Commission will not reopen pending proceedings in order to assess the impact of potential or hypothetical combinations or transactions. The proper forum for considering cumulative impacts and crossover effects is in a later proceeding. In this manner, consideration will be limited to the impacts of transactions which have already been approved and are, therefore, reasonably certain to occur. Furthermore, the Commission will have the benefit of its findings from the prior proceeding to identify more precisely the impacts of that transaction. Proceedings will remain manageable in scope and size, statutory time limits will be met, and all parties will be assured of timely, administratively final decisions.

(h) *Public participation.* To assure a fully developed record on the impacts of a proposed railroad consolidation, the Commission encourages public participation from Federal, State, and local government departments and agencies, affected shippers and carriers, and other interested persons.

1111.2 *Types of transactions.*

Transactions proposed under 49 U.S.C. 11343 involving more than one common carrier by railroad are of four types: *major, significant, minor,* and *exempt.*

(a) A *major* transaction is a control or merger involving two or more class I railroads.

(b) A *significant* transaction involves at least one class I railroad, acting together with one or more other class I or class II railroads, in a major market extension. It is of regional or national transportation significance as defined in 49 U.S.C. 11345.

(c) A *minor* transaction is one which involves more than one railroad and which is not a *major, significant,* or *exempt* transaction.

(d) A transaction is *exempt* if it is within one of the six categories described below. The Commission has found that its prior review and approval of these transactions (1) is not necessary to carry out the rail transportation policy of 49 U.S.C. 10101a; and (2) is of limited scope or unnecessary to protect shippers from market abuse. See 49 U.S.C. 10505. A notice must be filed to use one of these class exemptions. The procedures are set out in section 1111.4(g). These class exemptions do not relieve a carrier of its statutory obligation to protect the interests of employees. See 49 U.S.C. 10505(g)(2) and 11347. The enumeration of the following categories of transactions as exempt does not preclude a carrier from seeking an exemption of specific transactions not falling into these categories.

(1) Acquisition of a line of railroad which would not constitute a major market extension where the Commission has found that the public convenience and necessity permit abandonment.

(2) Acquisition of a nonconnecting carrier or one of its lines where (i) the railroads would not connect with each other or any railroads in their corporate family, (ii) the acquisition is not part of a series of anticipated transactions that would connect the railroads with each other or any railroad in their corporate family, and (iii) the transaction does not involve a class I carrier.

(3) Transactions within a corporate family that do not result in adverse changes in service levels, significant operational changes, or a change in the competitive balance with carriers outside the corporate family.

(4) Renewal of leases or trackage rights contracts and any other matters where the Commission has previously authorized the transaction, and only an extension in time is involved.

(5) Joint projects involving the relocation of a line of railroad which does not disrupt service to shippers.

(6) Reincorporation in a different State.

1111.3 *Definitions.*

(a) *Applicant.* The parties initiating a transaction. Parties who are considered applicants, but for whom the information normally required of an applicant need *not* be submitted, are (1) in *minor* trackage rights applications, the transferor and (2) in responsive applications, a primary applicant.

(b) *Applicant carriers.* Applicant, *all carriers related to the applicant,* and all other carriers involved in the transaction. This does not include carriers who are involved in an existing trackage rights agreement with applicants.

(c) *Major market extension.* A major market extension is a transaction which may significantly increase competition by extending service into a new market, expanding service in a currently served market when another carrier concurrently contracts its service to that market as part of the same transaction, or providing significantly more efficient and effective competitive service to a market presently being served. Criteria which can be used to determine if a railroad is proposing to provide a more competitive service to a currently served area include: (1) creating a shorter route; (2) providing enhanced service capabilities (speed is not the only factor); (3) entering an interchange or market generating more than 5,000 cars per year or 5 percent of applicant's traffic; (4) filing the application as a condition of relief to a pending proceeding; and (5) permitting a carrier to become more competitive (extending its length of haul). See, *Burlington Northern, Inc.—Control & Merger—St. L.*, 354 I.C.C. 616, 617 (1978).

(d) *Petition for clarification.* A request that the Commission clarify the applicability of any part of these regulations to a particular situation or explain the type of material needed to comply with these regulations.

(e) *Petition for waiver.* A request that the Commission either dispense with material required by the regulations, or accept material in place of that required by these regulations.

(f) *Primary application.* A proposal for approval filed under 49 U.S.C. 11343 which begins a new proceeding and is not proposed either as a condition to or as an alternative to Commission approval of another pending application.

(g) *Railroad.* Any common carrier by railroad as defined in 49 U.S.C. 10102(18)-(19).

(h) *Responsive applications.* Applications filed in response to a primary application seeking affirmative relief either as a condition to or in lieu of the approval of the primary application. Responsive applications include inconsistent applications, inclusion applications, and any other affirmative relief that requires an application to be filed with the Commission (such as trackage rights, purchases, construction, operation, pooling, terminal operations, abandonment, et cetera).

(i) *Transferee.* The transferee is:

(1) The acquiring corporation in a control proceeding,

(2) The surviving corporation in a merger,

(3) The resulting corporation in a consolidation,

(4) The lessee in a lease,

(5) The purchaser in an acquisition, and

(6) The grantee of trackage rights in a trackage rights proceeding.

(j) *Transferor.* The transferor is:

(1) The corporation acquired in a control proceeding,

(2) The merging corporation in a merger,

(3) All corporations to be consolidated in a consolidation,

(4) The lessor in a lease,

(5) The seller in an acquisition, and

(6) The grantor of trackage rights in a trackage rights proceeding.

1111.4 *Procedures.*

(a) *General.*

(1) The original and 20 copies of all documents shall be filed in *major* proceedings. The original and 10 copies shall be filed in *significant* and *minor* proceedings.

(2) Each party to a proceeding shall choose a unique acronym of four letters or less for itself. It shall number each document filed in the proceeding consecutively, prefixed by its acronym.

(3) Any document filed with the Commission (including applications, pleadings, et cetera) shall be promptly furnished to interested persons on request, unless subject to a protective order. At any time, the Commission may require the submission of additional copies of any document previously filed by any party to the proceeding.

(4) The Commission shall issue a list of all parties to the proceeding within 55 days of the application's acceptance in a *major* transaction, and within 45 days in a *significant* or *minor* transaction.

(b) *Prefiling notification.*

(1) Between 3 to 6 months prior to the proposed filing of an application in a *major* transaction, and 2 to 4 months prior to the proposed filing of an application in a *significant* transaction, applicant shall file a notice with the Commission. The notice shall:

(i) Briefly describe the transaction,

(ii) Indicate the year to be used for the impact analyses,

(iii) Indicate the approximate filing date of the application, and

(iv) Indicate why the transaction is *major* or *significant* (how a major market extension results).

(2) The Commission will publish a notice in the Federal Register within 30 days of receipt of the applicant's notice. The publication shall contain:

(i) A brief description of the transaction,

(ii) The year to be used for the impact analysis,

(iii) The approximate filing date,

(iv) A determination that the transaction is *major*, *significant*, or *minor*, and

(v) A statement of any additional information which must be filed with the application in order for the application to be considered complete.

(3) A prefiling notice may be amended to indicate a change in the anticipated filing date.

(c) *Application.*

(1) There is a $700 filing fee to file a primary application with the Commission under these procedures. There is no filing fee for a directly related application, a responsive application, or a notice of exemption.

(2) Filing requirements.

(i) The original of all applications shall be signed in ink by the applicant, if an individual; by all partners, if a partnership; and if a corporation, association, or other similar form of organization, by its president, or such other executive officer having knowledge of the matters therein contained and duly designated for that purpose by the applicant. Applications shall be made under oath and shall contain an appropriate certification (if a corporation, by its secretary) showing that the affiant is duly authorized to verify and file the application. Any person controlling an applicant shall also sign the application.

(ii) The application shall be filed with Secretary, Interstate Commerce Commission, Washington, DC 20423.

(iii) Each copy of the application shall conform in all respects to the original and shall be complete in itself except that the signature in the copies may be stamped or typed and the notarial seal may be omitted. In like manner, where certified copies of documents are filed with the application, conformed copies thereof, showing certification in stamped or typewritten form, will be sufficient to accompany the additional copies of the application.

(iv) All applications required to be filed with the Commission or served on designated persons shall include all exhibits, except as otherwise specifically noted. Information from other documents may be incorporated by reference in the application. However, the documents must have been filed with the Commission within 3 years prior to filing of the application, the information must be up to date, and applicant must be prepared to supply copies of this information to interested persons on specific request.

(v) The applicant shall submit such additional information to support its application as the Commission may require.

(vi) Applicant shall file concurrently all directly related applications, *e.g.*, those seeking authority to construct or abandon rail lines, to issue securities, control motor carriers, obtain terminal operations, acquire trackage rights, et cetera.

(vii) The application shall contain a certificate of service indicating that all persons designated in section 1111.4(c)(5) have been served with a copy of the application.

(3) In a *major* or *significant* transaction, and in all responsive applications, all of the direct testimony of applicants, in the form of verified statements, shall be filed and served with each application.

(4) The application and all exhibits shall be considered part of the evidentiary record upon acceptance. Any portion of an application and exhibits will remain subject to motions to strike. However, no motion need be made to have the application and exhibits admitted to the evidentiary record. If a *major* or *significant* transaction is designated for oral hearing the presiding Administrative Law Judge shall have discretion in extraordinary circumstances to allow for the presentation of oral or written direct testimony not previously submitted with the application.

(5) Service. The applicant shall serve a conformed copy of an application filed under these procedures by first-class mail upon:

(i) The Governor (or Executive Officer), Public Service Commission, and the Department of Transportation of each State in which any part of the properties of the applicant carriers involved in the proposed transaction is situated;

(ii) The Secretary of the United States Department of Transportation (Docket Clerk, Office of Chief Counsel, Federal Railroad Administration, Room 5101, 400 Seventh Street, SW, Washington, DC 20590);

(iii) The Attorney General of the United States;

(iv) The Federal Trade Commission; and

(v) In *major* or *significant* transactions, all persons requesting a copy after the prefiling notice is published in the Federal Register.

(6) Application format. (i) The application shall be in the same sequence as the information is requested in these procedures, and shall be numbered to correspond to the numbering in the procedures.

(ii) If any material required in the application would lend itself to being placed in an appendix, this should be done. The appendix and application shall be tabulated and cross-referenced in an index for ease in locating and referring to the information. The appendixes shall be in the same sequence as the information required by these procedures. If certain information required in the application is not applicable, provide an explanation. The application should be bound, and it may be bound in more than one volume. If an application is more than one volume, the cover of each volume should be in a different color. The pages in each volume shall begin with 1, and be sequentially numbered.

(iii) If a question arises regarding an interpretation of the information or format to be included in the application, the party may contact the Commission's Section of Finance for assistance. It will provide informal opinions and interpretations which are not binding on the Commission.

(iv) All filing, service, or other requirements of these procedures must be complied with when filing the application. Copies of the application filed with the Commission shall be marked in red "Railroad Consolidation Application" on the transmittal envelope or package.

(v) The application shall conform to the typographical specifications of 49 CFR 1100.13.

(7) Acceptance or rejection of an application.

(i) The Commission shall accept a complete application no later than 30 days after the application is filed with the Commission by publishing a notice in the Federal Register. A complete application contains all information for all applicant carriers required by these procedures, except as modified by advance waiver. The publication shall indicate the applicable time limits for processing the application. (These are the time limits of 49 U.S.C. 11345(b) for a *major* transaction, 49 U.S.C. 11345(c) for a *significant* transaction, and 49 U.S.C. 11345(d) for a *minor* transaction.)

(ii) The Commission shall reject an incomplete application by serving a decision no later than 30 days after the application is filed with the Commission. The decision shall explain specifically why the application was incomplete. A revised application may be submitted, incorporating portions of the prior application by reference. The resubmission or refiling of an application shall be considered a *de novo* filing for the purpose of computation of the time periods, provided that the resubmitted application is accepted as complete.

(8) The application must present a prima facie case. Applicants can fail to meet their burden of proof and thus not present a prima facie case either by (i) disclosing facts that, even if construed in their most favorable light, are insufficient to support a finding that the proposal is consistent with the public interest, or by (ii) disclosing facts that affirmatively demonstrate that the proposal is not in the public interest. See Ex Parte No. 282 (Sub-No. 3A), *Railroad Consolidation Procedures*, 363 I.C.C. 767 (1980).

(d) *Response to application.*

(1) Written comments.

(i) *Time to file.* (A) Written comments on a *major* transaction must be filed no later than 45 days after an application is accepted. (B) Written comments on *significant* or *minor* transactions must be filed within 30 days of the application's acceptance.

(ii) *Service.*—Written comments shall be concurrently served by first-class mail on:

(A) The applicants (at each address given in the application),

(B) The United States Secretary of Transportation,

(C) The Attorney General of the United States, and

(D) All parties of record within 10 days of service of the service list by the Commission.

(iii) *Contents.* Written comments must contain:

(A) The docket number and title of the proceeding.

(B) The name, address, and telephone number of the commenting party and its representative upon whom service shall be made.

(C) The commenting party's position (in support, opposition, or undetermined).

(D) If the commenting party intends to participate formally in a proceeding or merely comment upon the proposal.

(E) If desired, a request for an oral hearing with reasons supporting this request. The request must indicate the disputed material facts that can only be resolved at a hearing.

(F) A list of all information sought to be discovered from applicant carriers.

(G) A detailed statement of the issues in *major* and *significant* transactions reflecting the relevant underlying statutory criteria, policy statement (for *major* transactions), and antitrust policy which the Commission must consider in the proceeding.

(H) An initial list of specific protective conditions sought *by nonrailroads* in *major* and *significant* transactions.

(I) The following information *by railroads* filing written comments in *major* and *significant* transactions:

(*1*) Any existing preferential solicitation agreements.

(*2*) A list of all run-through train operations.

(*3*) An initial list of specific protective conditions sought and a statement concerning whether the commenting railroad intends to file responsive applications, along with a description of the proposed transactions. This will be considered a prefiling notice without which the Commission will not entertain responsive applications.

(iv) *Party.* All persons who file timely written comments shall be a party of record if they so indicate in their comments. In this event, no petition for leave to intervene need be filed.

(2) The Secretary of Transportation and Attorney General of the United States shall file written comments with the Commission within 60 days of the date of acceptance of the application in a *major* transaction. For *significant* and *minor* transactions these comments are due within 45 days of the date of acceptance of the application. These comments shall comply with paragraphs (d)(1) (ii) and (d)(1)(iii) of this section as to service and contents.

(3) A second list of protective conditions shall be filed with the Commission within 75 days of acceptance of the application in a *major* transaction, and within 60 days of acceptance of the application in a *significant* transaction. It shall be concurrently served by first-class mail on all parties of record. The second list of protective conditions shall modify the first list based upon changing conditions, such as protective conditions sought by other parties to the proceeding. Parties to the proceeding shall not be permitted to seek any protective conditions not contained in the second list of protective conditions. This does not preclude refinements in conditions sought, particularly when stipulations to conditions are reached.

(4) Responsive applications.

(i) All responsive applications in *major* transactions shall be filed 90 days, and in *significant* transactions 60 days, after acceptance of the primary application. No responsive applications shall be permitted to *minor* transactions.

(ii) Responsive applications which are not *major* are presumed to be *significant* transactions.

(iii) Responsive applications shall comply as fully as possible with appropriate Commission regulations. Extensions of time for filing are not permitted. The filing of an incomplete application, coupled with an extension of time to complete the application, may be permitted if authorized by the Commission in advance.

(iv) Any petitions for waiver, clarification, extension of time, or for leave to file an incomplete application, or to rebut the presumption of a *significant* transaction, must be filed in advance of the filing of the responsive application (at least 45 days in advance in *major* transactions and 30 days in *significant* transactions).

(v) Each responsive application filed and accepted (if required) is considered consolidated with the primary application.

(e) *Evidentiary proceeding.*

(1) The Commission may order an oral public hearing, a hearing by written submissions, or another kind of evidentiary proceeding. The determination will generally be made on the basis of the needs indicated by the written comments.

(2) The evidentiary proceeding will be completed:

(i) In 24 months (after the primary application is accepted) for a *major* transaction,

(ii) In 180 days for a *significant* transaction, and

(iii) In 105 days for a *minor* transaction;

(3) A final decision on the primary application and on all consolidated cases will be issued:

(i) In 180 days (after the conclusion of the evidentiary proceeding) for a *major* transaction,

(ii) In 90 days for a *significant* transaction, and

(iii) In 45 days for a *minor* transaction.

(4) The Secretary of Transportation may propose modifications to any transaction and shall have standing to appear before the Commission in support of any such proposed modification.

(f) *Waiver or clarification.*

(1) Upon petition of a prospective applicant, the Commission may waive or clarify a portion of these procedures. A petition to waive all of the procedures will not be entertained.

(2) Except as otherwise provided in paragraph (d)(4)(iv) of this section, petitions for waiver or clarification must be filed at least 45 days before the application is filed.

(3) No replies to a petition for waiver will be permitted, except where a proceeding involving the same parties and a related transaction is pending before us.[1] When a reply is permitted, the petition shall be served by first-class mail on all parties to the pending proceedings, with a reply due within 10 days of service. Replies to a petition for clarification shall be permitted within 10 days of the petition's filing.

(4) A waiver or clarification granted to any applicant in a proceeding shall apply to any other party to the proceeding unless otherwise indicated.

(5) All petitions for waiver or clarification must specify the sections for which waiver or clarification is sought and give the specific reasons why each waiver or clarification is necessary.

(g) *Notice of exemption.*

(1) To qualify for an exemption under section 1111.2(d), a railroad must file a verified notice of the transaction with the Commission at least 1 week before the transaction is consummated indicating the proposed consummation date.

(2) The notice shall contain the information required in section 1111.6(a)(1)(i-iii), (a)(5-6), and (a)(7)(ii), and indicate the level of labor protection to be imposed.

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[1] See *Itel Corp.—Control—Green Bay and W.R. Co.*, 354 I.C.C. 232, 233 (1978).

(3) The Commission shall publish a notice in the Federal Register within 30 days of the filing of the notice of exemption. The publication will indicate the labor protection required. If the notice of exemption contains false or misleading information which is brought to the Commission's attention, the Commission shall summarily revoke the exemption for that carrier and require divestiture.

(h) *Official notice.* In connection with any application or request for relief under these procedures, the Commission may take official notice of any or all of the following information.

These data will be presumed valid unless discredited by any party.

A party relying on information to be noticed officially shall list the information. Upon request, the party shall make the official notice material available.

Any party is free to challenge the relevance or application of any such data, or the weight that should be accorded it.

(1) Annual ICC Form R-1 Reports submitted by rail carriers.

(2) Quarterly Commodity Statistics submitted by rail carriers.

(3) ICC Monthly Labor Statistics.

(4) Quarterly Financial Statements of Rail Carriers.

(5) All other reports submitted to the ICC under oath.

(6) Annual 1-percent Waybill Sample.

(7) Federal Reserve Board Production Statistics.

(8) AAR compilations of bad order ratios, equipment ownership and repair statistics, and freight car order figures.

These data will be presumed valid unless discredited by any party.

A party relying on information to be noticed officially shall list the information. Upon request, the party shall make the official notice material available.

Any party is free to challenge the relevance or application of any such data, or the weight that should be accorded it.

(1) *Untimely decision.* If the Commission does not issue a timely decision that is a final action under 49 U.S.C. 10327, it will send written notice to Congress that the decision was not issued and the reasons why it was not issued.

1111.5 Reserved

1111.6 *Supporting information.*

(a) All applications filed under 49 U.S.C. 11343 shall show in the title the names of the applicants and the nature of the proposed transaction. Beneath the title indicate the name, title, business address, and telephone number of the person(s) to whom correspondence with respect to the application should be addressed. The following information shall be included in all applications:

(1) A description of the proposed transaction, including appropriate references to any supporting exhibits and statements contained in the application and discussing the following:

(i) A brief summary of the proposed transaction, the name of applicants, their business address, telephone number, and the name of the counsel to whom questions regarding the transaction can be addressed.

(ii) The proposed time schedule for consummation of the proposed transaction.

(iii) The purpose sought to be accomplished by the proposed transaction, *e.g.*, operating economies, eliminating excess facilities, improving service, or improving the financial viability of the applicants.

(iv) The nature and amount of any new securities or other financial arrangements.

(2) A detailed discussion of the public interest justifications in support of the application, indicating how the proposed transaction is consistent with the public interest, with particular regard to the relevant statutory criteria, including:

(i) The effect of the transaction on inter- and intramodal competition, including a description of the relevant markets (see section 1111.7). Include a discussion of whether, as a result of the transaction, there is likely to be any lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region of the United States.

(ii) The financial consideration involved in the proposed transaction, and any economies, to be effected in operations, and any increase in traffic, revenues, earnings available for fixed charges, and net earnings, expected to result from the consummation of the proposed transaction.

(iii) The effect of the increase, if any, of total fixed charges resulting from the proposed transaction.

(iv) The effect of the proposed transaction upon the adequacy of transportation service to the public, as measured by the continuation of essential transportation services by applicants and other carriers.

(v) The effect of the proposed transaction upon applicant carriers' employees (by class or craft), the geographic points where the impact will occur, the time frame of the impact (for at least 3 years after consolidation), and whether any employee protection agreements have been reached.

(vi) The effect of inclusion (or lack of inclusion) in the proposed transaction of other railroads in the territory, under 49 U.S.C. 11344.

(3) Any other supporting or descriptive statements applicants deem material.

(4) An opinion of applicants' counsel that the transaction meets the requirements of the law and will be legally authorized and valid, if approved by the Commission. This should include specific references to any pertinent provisions of applicants' bylaws or charter or articles of incorporation.[2]

(5) A list of the State(s) in which any part of the property of each applicant carrier is situated.

(6) Map (exhibit 1). Submit a general or key map indicating clearly, in separate colors or otherwise, the line(s) of applicant carriers in their true relation to each other, short line connections, other rail lines in the territory, and the principal geographic points in the region traversed. If a geographically limited transaction is proposed, a map detailing the transaction should also be included. In addition to the map accompanying each application, 20 unbound copies of the map shall be filed with the Commission.

(7) Explanation of the transaction.

(i) Describe the nature of the transaction (*e.g.*, merger, control, purchase, trackage rights), the significant terms and conditions, and the consideration to be paid (monetary or otherwise).

(ii) Agreement (exhibit 2). Submit a copy of any contract or other written instrument entered into, or proposed to be entered into, pertaining to the proposed transaction.[3]

(iii) If a consolidation or merger is proposed, indicate: (A) the name of the company resulting from the consolidation or merger; (B) the State or territory under the laws of which the consolidated company is to be formed or the merged company is to file its certificate of amendment; (C) the capitalization proposed for the resulting company; and (D) the amount and character of capital stock and other securities to be issued.

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[2] An opinion of counsel is not required in a control transaction for the party sought to be controlled, or in a responsive application for the party against whom relief is sought.

[3] A final signed contract or agreement need not be filed with a responsive application. However, a draft contract or agreement should be submitted containing the significant terms proposed.

(iv) Court order (exhibit 3). If a trustee, receiver, assignee, or personal representative of the real party in interest is an applicant, submit a certified copy of the order, if any, of the court having jurisdiction, authorizing the contemplated action.

(v) State whether the property involved in the proposed transaction includes all the property of the applicant carriers and, if not, describe what property is included in the proposed transaction.

(vi) Briefly describe the principal routes and termini of the lines involved, the principal points of interchange on the routes, and the amount of main-line mileage and branch line mileage involved.

(vii) State whether any governmental financial assistance is involved in the proposed transaction and, if so, the form, amount, source, and application of such financial assistance.

(8) Environmental data (exhibit 4). Submit information and data with respect to environmental matters prepared in accordance with 49 CFR 1108. In *major* and *significant* transactions, applicants shall, as soon as possible, and no later than the filing of a notice of intent, consult with the Commission's Energy and Environment Branch for the proper format of the environmental report.

(9) Energy data (exhibit 5). Submit information and data with respect to energy consumption prepared in accordance with 49 CFR 1106.

(b) Submit the following information in a *major* or *significant* transaction:

(1) Form 10-K (exhibit 6). Submit applicant carriers' most recent filing with the Securities and Exchange Commission (SEC) under 17 CFR 249.310. This shall not be incorporated by reference, and shall be updated with any Form 10-K subsequently filed with the SEC over the duration of the proceeding.

(2) Form S-14 (exhibit 7). Submit applicant carriers' most recent filing with the SEC under 17 CFR 239.23. This shall not be incorporated by reference, and shall be updated with any Form S-14 subsequently filed with the SEC over the duration of the proceeding.

(3) Change in control (exhibit 8). Indicate any change in ownership, control, or officers not indicated in the most recent annual report Form R-1.

(4) Annual reports (exhibit 9). Submit applicant carriers' two most recent annual reports to stockholders. This shall not be incorporated by reference, and shall be updated with any annual or quarterly report to stockholders issued over the duration of the proceeding.

(5) Issues (exhibit 10). Submit a discussion of any other issues relevant to the transaction.

(6) Corporate chart (exhibit 11). Submit a corporate chart indicating all relationships between applicant carriers and all affiliates and subsidiaries and also companies controlling applicant carriers directly, indirectly or through another entity (each chart shall indicate the percentage ownership of every company on the chart by any other company on the chart). For each company include a statement indicating (i) any common officers or directors for every entity on the chart (with reference to the Commission decision by docket number and date authorizing the holding of such positions, or an explanation of why such authorization was not required) and (ii) whether each company is a noncarrier or carrier (by railroad, motor, or water, including the number of any Commission certificate or permit, and the docket number of any proceeding pending before the Commission). Such information may be referenced through notes to the chart.

(7) If applicant is not a carrier, indicate (i) the type of business in which it is engaged, (ii) the length of time so engaged, and (iii) its present and prospective activities which have or may have a relation to transportation subject to 49 U.S.C. Subtitle IV.

(8) Indicate whether there are any direct or indirect intercorporate or financial relationships at the time the application is filed, not disclosed elsewhere in the application, through holding companies, ownership of securities, or otherwise, between (i) applicant carriers and any carrier or person affiliated with any carrier or (ii) a person affiliated with applicant carriers and any carrier or person affiliated with any other carrier. Indicate the nature and extent of such relationships, if they exist, and, if an applicant carrier owns securities of a carrier subject to 49 U.S.C. Subtitle IV provide the carrier's name, a description of securities, par value of each class of securities held, and the applicant carriers' percentage of total ownership.

1111.7 *Market analyses.*

Impact analyses (exhibit 12). In *major* and *significant* transactions applicants shall submit analyses of the impacts of the proposed transaction—both adverse and beneficial—on inter- and intramodal competition for flight surface transportation in the regions affected by the transaction and on the provision of essential services by applicants and other carriers. An impact analysis should include underlying data, a study of the implications of that data, and a description of the resulting likely effects of the transaction on transportation alternatives available to the shipping public. Each aspect of the analysis should specifically address significant impacts as they relate to the statutory criteria (49 U.S.C. 11344(b) or (d), essential services, and competition). The Commission may identify particular markets and issues that it believes warrant further study. If appropriate, the Commission will also indicate the format of such analyses. Applicants must address markets and issues identified by the Commission, but also any others they consider relevant. Specific regulations on impact analyses are not provided so that parties will have the greatest leeway to develop the best evidence on the impacts of each individual transaction. General guidelines follow.

(a) Applicants shall prepare analyses of the anticipated effects of the transaction on traffic patterns, market concentrations, or transportation alternatives available to the shipping public.

(b) Applicants (and any other party submitting such analyses) must demonstrate both the relevancy of the market and issues analyzed and the validity of the methodology. All underlying assumptions must be clearly stated.

(c) Supporting data may (but need not) include: current and projected traffic flows; data underlying sales forecasts or marketing goals; interchange data; market share analysis; diversion studies; and/or shipper surveys. *It is important to note that these types of studies are neither limiting nor all inclusive.* The parties must provide supporting data, but are free to choose the type(s) and format.

(d) Analyses should reflect the consolidated company's marketing plan and existing and potential competitive alternatives (inter- as well intramodal). They can address:

(1) City pairs, interregional movements, movements through a point, or other factors;

(2) A particular commodity, group of commodities, or other commodity factor that will be significantly affected by the transaction; or

(3) Other effects of the transaction (such as on a particular type of service offered).

1111.8 *Operational data.*

(a) For *major* and *significant* transactions: Operating plan (exhibit 13). Submit a summary of the proposed operating plan changes, based on the impact analyses, that will result from the transaction, and their anticipated timing, allowing for any time required to complete rehabilitation, upgrading, yard construction, or other major operational changes following consummation of the proposed transaction. The plan should make clear the gains in service, operating efficiencies, and other benefits anticipated from the merger. The plan should include:

(1) The patterns of service on the properties, including the proposed principal routes, proposed consolidations of main-line operations, and the anticipated traffic density and general categories of traffic (including numbers of trains) on all main and secondary lines in the system. Identify all yards expected to have an increase in activity greater than 20 percent. Changes in operations may be summarized in a *pro forma* density chart.

(2) If commuter or other passenger services are operated over the lines of applicant carriers, detail any impacts anticipated on such services, including delays which may be occasioned because a line is scheduled to handle increased traffic due to route consolidations.

(3) The anticipated equipment requirements of the proposed system, including locomotives, rolling stock by type, and maintenance-of-way equipment; plans for acquisition and retirement of equipment; projected improvements in equipment utilization and their relation to operating changes; and how these will lead to the financial and service benefits described in the summary.

(4) A description of the effect of any deferred maintenance or delayed capital improvements on any road or equipment properties involved, the schedule for eliminating such deferrals, details of general system rehabilitation including rehabilitation relating to the transaction (including proposed yard and terminal modifications), and how these activities will lead to the service improvements or operating economies anticipated from the transaction.

(5) Density charts (exhibit 14). Gross ton-mile traffic density charts shall be filed for applicant carriers containing a map geographically showing those lines handling 1 million gross ton-miles per-mile road or more per year and respective densities, expressed in gross ton-miles per year, in each direction, in segments of such lines between major freight yards and terminals, including major intramodal and intermodal interchange points, using the corporate or political subdivision name of the points shown as well as the railroad station name. The mileage of each segment of line shall be provided, and should be shown on the chart. Data shown in the density chart shall be for the latest available full calendar year preceding the filing of the application. At applicants' option data may be shown on the density chart or an explanatory list.

(b) For *minor* transactions: Operating plan-minor (exhibit 15). Discuss any significant changes in patterns or types of service as reflected by the operating plan expected to be used after consummation of the transaction. Where relevant, submit information related to the following:

(1) Traffic level and density on lines proposed for joint operations.

(2) Impacts on commuter or other passenger service operated over a line which is to be downgraded, eliminated, or operated on a consolidated basis.

(3) Operating economies, which include, but are not limited to, estimated savings.

(4) Any anticipated discontinuances or abandonments.

1111.9 *Financial information.*

The following information shall be provided for *major* and *significant* transactions, and for carriers shall conform to the Commission's Uniform System of Accounts, 49 CFR Part 1201:

(a) *Pro forma* balance sheet (exhibit 16). Where the transaction involves a proceeding other than a control, a *pro forma* balance sheet statement giving effect to the proposed transaction commencing for the first year of the Impact Analysis in exhibit 12. The data shall be presented in columnar form showing (1) in the *first* column, the balance sheet of transferee on a corporate entity basis, (2) in the *second* column, a balance sheet of transferor, on a corporate entity basis, (3) in the *third* column, *pro forma* adjustments and eliminations; and (4) in the *fourth* column, transferee's balance sheet giving effect to consummation of the proposed transaction.[4] Each adjustment and elimination shall be properly footnoted and fully explained. A *pro forma* balance sheet shall be submitted for the number of years following consummation necessary to effect the operating plan.

(b) *Pro forma* income statement (exhibit 17). Where the transaction involves a proceeding other than a control, submit a *pro forma* income statement showing transferee's estimate of revenues, expenses, and net income for at least each of the 3 years following consummation of the transaction.[5] The *pro forma* data shall be presented in columnar form, showing (1) in the *first* column, transferee's actual income statement on a corporate entity basis for the year indicated in the impact analysis in exhibit 12; (2) in the *second* column, a similar income statement for the transferor; (3) in the *third* column, forecasted adjustments to the combined revenues, expenses, and net income to reflect increases or decreases anticipated under the unified operations, and (4) in the *fourth* column, a compilation of the first three columns into a *pro forma* income statement.[6] The adjustments are to be supported by a statement explaining the basis used in determining the estimated changes in revenues, expenses, and net income appearing in the *third* column. Additionally, if the major financial advantages to be derived from the proposed transaction will not occur within 3 years after consummation, then applicant shall furnish additional information to reflect the number of years within which the financial advantages will be realized. The basis for all such data furnished shall be fully explained and supported.

(c) Sources and application of funds (exhibit 18). Transferor's and transferee's statement of sources and application of funds for the current year, and a forecast[7] of sources and application of funds for each carrier (if a merger or consolidation, the surviving or resulting corporation) for the year following consummation of the proposed transaction, and the years necessary to effectuate the operating plan.[8] The form and content of these statements should be constructed in accordance with the schedule: "Statement of Changes in Financial Position" required in the most recently filed Annual Report R-1 for class I railroads.

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[4] Where the purchase of a line or line segment is involved, a procedure utilizing three columns should be followed. The *first* column should show transferee's actual balance sheet on a corporate entity basis for the latest available 12-month period, the *second* column should show the adjustments necessitated by the purchase, and the *third* is a compilation of the first two columns into a *pro forma* balance sheet.

The transferor shall file a balance sheet similar to the one filed by the transferee, with the *second* column reflecting the adjustments resulting from the sale.

If the parent company (if any) of the transferee or transferor is affected, a similar balance sheet shall be filed for each.

All adjustments to these balance sheets shall be supported in footnotes to the appropriate balance sheet.

[5] If the operating plan requires more than 3 years to be put into effect, the *pro forma* income statement shall be prepared for as many years as necessary to implement fully the operating plan.

[6] Where the purchase of a line or line segment is involved, a procedure utilizing three columns should be followed. The *first* column should show transferee's actual income statement on a corporate entity basis for the latest available 12-month period, the *second* column should show the adjustment necessitated by the purchase, and the *third* column is a compilation of the first two columns into a *pro forma* income statement.

The transferor shall file an income statement similar to the one filed by the transferee, with the second column reflecting the adjustments resulting from the sale.

If the parent company (if any) of the transferor or transferee is affected, a similar statement shall be filed for each.

All adjustments to these income statements shall be supported in footnotes to the appropriate income statements.

[7] The forecast should reflect only changes anticipated to result from the proposed transaction. Forecasts are not required to reflect general economic conditions unrelated to the proposed transaction.

[8] The *pro forma* balance sheets (exhibit 16), *pro forma* income statements (exhibit 17), and sources and application of funds (exhibit 18) shall cover the same years.

(d) Property encumbrance (exhibit 19). If any of the property covered by the application is encumbered and applicant has agreed to assume obligation or liability in respect thereof, submit:

(1) A description of the property encumbered.

(2) Amount of encumbrance and full description thereof, including maturity, interest rate, and other terms and conditions.

(3) Amount of encumbrance assumed or to be assumed by applicant.

(e) The Commission will incorporate by reference the current balance sheets and income statements of class I railroads which are on file with the Commission. Class II and class III railroads, and noncarrier entities shall submit balance sheets (exhibit 20) and income statements (exhibit 21) covering a period ending within 6 months before the application is filed.

1111.10-19 [*Reserved*]

INDEX I FOR SUBPART A

Exhibits

Number	Name	Section	Type of application
1	Map	1111.6(a)(6)	All
2	Agreement	1111.6(a)(7)(ii)	Do.
3	Court order	1111.6(a)(7)(iv)	Do.
4	Environmental data	1111.6(a)(8)	Do.
5	Energy data	1111.6(a)(9)	Do.
6	Form 10-K	1111.6(b)(1)	Major and Significant
7	Form S-14	1111.6(b)(2)	Do.
8	Change in control	1111.6(b)(3)	Do.
9	Annual reports	1111.6(b)(4)	Do.
10	Issues	1111.6(b)(5)	Do.
11	Corporate chart	1111.6(b)(6)	Do.
12	Market analyses	1111.7	Do.
13	Operating plan - major	1111.8(a)	Do.
14	Density charts	1111.8(a)(5)	Do.
15	Operating plan - minor	1111.8(b)	Minor
16	Pro forma balance sheets	1111.9(a)	Major and Significant
17	Pro forma income statements	1111.9(b)	Do.
18	Sources and application of funds	1111.9(c)	Do.
19	Property encumbrance	1111.9(d)	Do.
20	Balance sheet - minor	1111.9(e)	Minor
21	Income statement - minor	1111.9(e)	Do.

INDEX II FOR SUBPART A

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Section		
Number	Name	Application type[1]
1111.0	Scope and purpose	All
1111.1	General policy statement	Major (Mjr)
(a)	General	Do.
(b)	Consolidation criteria	Do.
(c)	Public interest considerations	Do.
(c)(1)	Potential benefits	Do.
(c)(2)	Potential harm	Do.
(c)(2)(i)	Reduction of competition	Do.
(c)(2)(ii)	Harm to essential service	Do.
(d)	Conditions	Do.
(e)	Inclusion of other carriers	Do.
(f)	Labor protection	Do.
(g)	Cumulative imparts and crossover effects	Do.
(h)	Public participation	Do.
1111.2	Types of transactions	
(a)	Major	Major
(b)	Significant	Significant (Sgt.)
(c)	Minor	Minor
(d)	Exempt	Exempt
(d)(1)	Acquisition-carrier	Do.
(d)(2)	Acquisition-line	Do.
(d)(3)	Within corporate family	Do.
(d)(4)	Renewals	Do.
(d)(5)	Relocations	Do.
(d)(6)	Reincorporation	Do.
1111.3	Definitions	All
(a)	Applicant	Do.
(b)	Applicant carriers	Do.
(c)	Major market extension	Do.
(d)	Petition for clarification	Do.
(e)	Petition for waiver	Do.
(f)	Primary application	Do.
(g)	Railroad	Do.
(h)	Responsive application	Mjr. and Sgt.
(i)	Transferee	All
(j)	Transferor	Do.
1111.4	Procedures	Do.
(a)	General	Do.
(a)(1)	Copies filed	Do.
(a)(2)	Acronym	Do.
(a)(3)	Furnishing documents	Do.
(a)(4)	Service list	Do.
(b)	Prefiling notification	Mjr. and Sgt.
(b)(1)	Carrier action	Do.
(b)(1)(i)	Description	Do.

See footnote at end of table.

Tables of contents—Continued

Section		
Number	Name	Application type[1]
1111.4		
(b)(1)(ii)	Impact analyses year	Do.
(b)(1)(iii)	Filing date	Do.
(b)(1)(iv)	Major or significant	Do.
(b)(2)	Commission action	Do.
(b)(2)(i)	Description	Do.
(b)(2)(ii)	Impact analyses year	Do.
(b)(2)(iii)	Filing date	Do.
(b)(2)(iv)	Major or significant	Do.
(b)(2)(v)	Additional information	Do.
(b)(3)	Amendment	Do.
(c)	Application	All
(c)(1)	Filing fee	Do.
(c)(2)	Filing	Do.
(c)(2)(i)	Signed under oath	Do.
(c)(2)(ii)	Filed with secretary	Do.
(c)(2)(iii)	Copies conform to original	Do.
(c)(2)(iv)	Include exhibits	Do.
(c)(2)(v)	Additional information	Do.
(c)(2)(vi)	Directly related applications	Do.
(c)(2)(vii)	Certificate of service	Do.
(c)(3)	Direct testimony	Mjr. and Sgt.
(c)(4)	Evidentiary record	All
(c)(5)	Service	Do.
(c)(5)(i)	States	Do.
(c)(5)(ii)	U.S. Department of Transportation	Do.
(c)(5)(iii)	U.S. Attorney General	Do.
(c)(5)(iv)	Federal Trade Commission	Do.
(c)(5)(v)	Others	Mjr. and Sgt.
(c)(6)	Application format	All
(c)(6)(i)	Sequence	Do.
(c)(6)(ii)	Appendix, volumes, and numbering	Do.
(c)(6)(iii)	Interpretation	Do.
(c)(6)(iv)	Compliance	Do.
(c)(6)(v)	Typographical specifications	Do.
(c)(7)	Acceptance or rejection	Do.
(c)(7)(i)	Acceptance	Do.
(c)(7)(ii)	Rejection	Do.
(c)(8)	Prima facie case	Do.
(d)	Response to application	Do.
(d)(1)	Written comments	Do.
(d)(1)(i)	When filed	Do.
(d)(1)(ii)	Service	Do.
(d)(1)(ii)(A)	Applicants	Do.
(d)(1)(ii)(B)	U.S. Department of Transportation	Do.
(d)(1)(ii)(C)	U.S. Attorney General	Do.

See footnote at end of table.

Tables of contents—Continued

Section		
Number	Name	Application type[1]
1111.4		
(d)(1)(ii)(D)	Parties on service list	Do.
(d)(1)(iii)	Contents	Do.
(d)(1)(iii)(A)	Docket number and title	Do.
(d)(1)(iii)(B)	Representative	Do.
(d)(1)(iii)(C)	Position	Do.
(d)(1)(iii)(D)	Participation	All
(d)(1)(iii)(E)	Oral hearing request	Do.
(d)(1)(iii)(F)	Discovery	Do.
(d)(1)(iii)(G)	Issues	Mjr. and Sgt.
(d)(1)(iii)(H)	Protective conditions-initial-nonrail	Do.
(d)(1)(iii)(I)	Railroad information	Do.
(d)(1)(iii)(I)(1)	Preferential solication agreements	Do.
(d)(1)(iii)(I)(2)	Run through train operations	Do.
(d)(1)(iii)(I)(3)	Protective conditions-initial	Do.
(d)(1)(iv)	Party of record	Do.
(d)(2)	Comments of DOT and Justice	All
(d)(3)	Protective conditions-final	Mjr. and Sgt.
(d)(4)	Responsive applications	All
(d)(4)(i)	Filing time	
(d)(4)(ii)	Significant	Mjr. and Sgt.
(d)(4)(iii)	Compliance; extension of time to complete	Do.
(d)(4)(iv)	Petitions-time	Do.
(d)(4)(v)	Consolidated	Do.
(e)(1)	Hearing designation	All
(e)(2)	Evidentiary time periods	Do.
(e)(2)(i)	Major	Major
(e)(2)(ii)	Significant	Significant
(e)(2)(iii)	Minor	Minor
(e)(3)	Decisional time periods	All
(e)(3)(i)	Major	Major
(e)(3)(ii)	Significant	Significant
(e)(3)(iii)	Minor	Minor
(e)(4)	U.S. Department of Transportation participation	All
(f)	Waiver or clarification	Do.
(f)(1)	Petition required	Do.
(f)(2)	When filed	Do.
(f)(3)	No replies to petition	Do.
(f)(4)	Application of waiver to other parties	Do.
(f)(5)	Specificity of waiver	Do.
(g)	Notice of exemption	Exemption
(g)(1)	When filed	Do.
(g)(2)	Contents	Do.
(g)(3)	Commission action	Do.
(h)	Official notice	All
(h)(1)	R-1 Report	Do.

See footnote at end of table.

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Section		
Number	Name	Application type[1]
1111.4		
(h)(2)	Quarterly commodity statistics	Do.
(h)(3)	Labor statistics	Do.
(h)(4)	Quarterly financial reports	Do.
(h)(5)	Other reports	Do.
(h)(6)	Waybill sample	Do.
(h)(7)	Production statistics	Do.
(h)(8)	AAR compilations	Do.
(i)	Untimely decision	Do.
1111.5 Reserved		
1111.6	Supporting information	All
(a)	All applications	Do.
(a)(1)	Descriptions	Do.
(a)(1)(i)	Summary	Do.
(a)(1)(ii)	Time schedule	Do.
(a)(1)(iii)	Purposes	Do.
(a)(1)(iv)	Financial arrangements	Do.
(a)(2)	Public interest	Do.
(a)(2)(i)	Competition	Do.
(a)(2)(ii)	Financial consideration	Do.
(a)(2)(iii)	Fixed charges	Do.
(a)(2)(iv)	Adequate service	Do.
(a)(2)(v)	Employees	Do.
(a)(2)(vi)	Inclusion	Do.
(a)(3)	Other support	Do.
(a)(4)	Opinion of Counsel	Do.
(a)(5)	States	Do.
(a)(6)	Map	Do.
(a)(7)	Explanation of transaction	Do.
(a)(7)(i)	Nature of transaction	Do.
(a)(7)(ii)	Agreement	Do.
(a)(7)(iii)	Resulting merged company	Do.
(a)(7)(iv)	Court order	Do.
(a)(7)(v)	Property involved	Do.
(a)(7)(vi)	Routes	Do.
(a)(7)(vii)	Governmental financial assistance	Do.
(a)(8)	Environmental data	Do.
(a)(9)	Energy data	Do.
(b)	Major or significant transaction	Mjr. and Sgt
(b)(1)	Form 10-K	Do.
(b)(2)	Form S-14	Do.
(b)(3)	Change in control	Do.
(b)(4)	Annual reports	Do.
(b)(5)	Issues	Do.
(b)(6)	Corporate chart	Do.
(b)(6)(i)	Common officer or directors	Do.
(b)(6)(ii)	Carrier or non-carrier	Do.

See footnote at end of table.

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Section		
Number	Name	Application type[1]
1111.6		
(b)(7)	Noncarrier information	Do.
(b)(8)	Relationships	Do.
1111.7	Market analyses	Do.
	Impact analysis	Do.
(a)	Traffic pattern, market concentration, and transportation alternatives.	Do.
(b)	Relevancy and validity	Do.
(c)	Supporting data	Do.
(d)	Marketing plan and competitive alternatives affects	Do.
(d)(1)	Movements	Do.
(d)(2)	Commodity	Do.
(d)(3)	Other	Do.
1111.8	Operational data	
	Major transactions-operating plan	Do.
(a)(1)	Patterns of service	Do.
(a)(2)	Passenger service	Do.
(a)(3)	Equipment requirements	Do.
(a)(4)	Condition of properties	Do.
(a)(5)	Density charts	Do.
(b)	Minor transaction-operating plan	Minor
(b)(1)	Traffic level	Do.
(b)(2)	Passenger service	Do.
(b)(3)	Operating economies	Do.
(b)(4)	Abandonments	Do.
1111.9	Financial information	
(a)	Pro forma balance sheets	Mjr. and Sgt.
(b)	Pro forma income statement	Do.
(c)	Sources and applications of funds	Do.
(d)	Property encumbrance	Do.
(d)(1)	Description	Do.
(d)(2)	Amount	Do.
(d)(3)	Assumption	Do.
(e)	Balance sheet and income statement—minor	Minor
1111.10-.19	Reserved	
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[1] Major is defined in section 1111.2(a). Significant is defined in section 1111.2(b). Minor is defined in section 1111.2(c). Exemption is defined in section 1111.2(d). "All" includes major, significant, and minor.

EC

SERVICE DAT
JUN 8 1981

INTERSTATE COMMERCE COMMISSION

Finance Docket No. 28583 (Sub-No. 1)

BURLINGTON NORTHERN, INC.-CONTROL AND MERGER-ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY

Finance Docket No. 21478

GREAT NORTHERN PACIFIC & BURLINGTON LINES, INC.-MERGER, ETC.- GREAT NORTHERN RAILWAY COMPANY, ET AL.

Decided: June 5, 1981

We have received three petitions relating to the expected formation by Burlington Northern, Inc. (BN) of a holding company and BN's reply to one of them. For reasons discussed below, we shall deny all three: the petition filed by the General Committees of Adjustments, Burlington Northern, Inc. (GCA); the petition filed by the Montana State Legislative Committee of the Brotherhood of Railway & Airline Clerks (BRAC); and the petition filed by the State of Minnesota (Minnesota).

BACKGROUND

BN is a railroad which owns a number of transportation and non-transportation companies and assets. It plans to create a holding company to own it.

BN believes that a holding company will facilitate the development of its transportation, natural resources, and other non-transportation businesses. Since the securities issuances of the noncarrier holding company would not be subject to our regulation, BN believes it would have greater flexibility to finance non-transportation business activities, to expand through acquisition of new businesses, and to develop natural resources owned by it or its subsidiaries. BN has also indicated that it is likely some of its natural resources and non-railroad properties could be transferred to the holding company or a subsidiary of the holding company. BN indicate that transfers of some of its natural resource properties may be limited by certain mortgages.

BN has created the Burlington Northern Holding Company (Holding Company) and its wholly owned subsidiary, Burlington Northern Transportation Company (BNTCO). On April 2, 1981, BN and BNTCO entered into an agreement whereby BNTCO would be merged into BN. The outstanding common and preferred stock of BN would then be exchanged for common and preferred stock of the Holding Company. The stockholders of BN would then become the stockholders of Holding Company. The name of BN would be changed to Burlington Northern Railroad Company and the name of Holding Company would be changed to Burlington Northern Inc. BN's stockholders approved the holding company proposal at their annual meeting on May 14, 1981.

JURISDICTION UNDER 49 U.S.C. 11343

Under 49 U.S.C. §11343(a)(4) the Commission has jurisdiction over an "acquisition of control . . . by a person that is not a carrier" only if control is sought over "at least 2 carriers."

GCA and Minnesota ask us to exert jurisdiction on the ground that Holding Company's proposed control over BN and its assets (including carrier subsidiaries) is an "acquisition of control of at least 2 carriers." Although BN controls a number of carriers, all the carrier operations are conducted as part of a single integrated system. For over 25 years the Commission has held that it does not have jurisdiction over a noncarrier's acquisition of control of a single integrated rail system and we see no reason to modify this statutory construction.

Under the single system doctrine, the Commission does not have jurisdiction under 49 U.S.C. §11343 over a noncarrier's acquisition of control of a single integrated rail system, even if the system is comprised of separate corporations. See Louisville & J. B. & R. Co. Merger, 290 I.C.C. 725 and 295 I.C.C. 11 (1955), aff'd sub nom. Alleghany Corp. et al v. Breswick & Co. et al, 353 U.S. 151 (1957). This doctrine has been followed in numerous cases, including several in which a holding company was created from a railroad. See Kansas City Southern Industries, Inc.-Control, 317 I.C.C. 1 (1962) (KCS case), Katy Industries, Inc.-Control-Missouri K.-T.R. Co., 331 I.C.C. 405 (1967), (Katy case) and Southern Pacific Transportation Co.-Merger, 334 I.C.C. 866 (1969) (SP case).

BN's formation of a holding company fits within this doctrine. BN controls a number of carriers, including the Colorado and Southern Railway Company, Fort Worth and Denver Railway Company, Walla Walla Valley Railroad Company, Oregon Electric Railway Company, BN Transport Company Inc., and Frisco Transportation Company. However, as demonstrated in the verified statement attached to BN's reply, BN operates all of these companies as an integrated transportation system, under the direct control and management of BN. Their capital budget and performance plans are either established or approved annually by BN. Their accounts are supervised by BN, and their financial results are consolidated with BN's for reporting purposes.

Each rail carrier subsidiary is required to maintain excess cash in BN's surplus cash account, and each is permitted to draw from the account as required. BN determines equipment purchases and assigns motive power on a daily basis for each of its rail carrier subsidiaries. The rail carrier subsidiaries solicit traffic for each other and do not compete. The directors of each subsidiary are selected by BN and are usually directors or officers of BN. The principal officers of each subsidiary are also usually officers of BN.

The revenues of the motor carrier subsidiaries are generally derived from services performed for BN, including substitute line-haul service, ramping, deramping and drayage, and transportation of BN-owned material. Intercorporate hauling for BN and about 25 of its subsidiaries is also performed by motor carrier subsidiaries. They lease facilities from BN, obtain substantial management support from BN, and have common officers and directors in a number of instances.

The actual operation of BN and its subsidiaries is clearly as a single system within the scope of the established doctrine. In the KCS, Katy and SP cases, motor carrier subsidiaries were also involved when the Commission determined that it did not have jurisdiction under the single system doctrine. In the SP case, pg. 867, footnote 2, it was found that the creation of a holding company to control a railroad which in turn controlled a motor carrier constituted a change in form, rather than substance, of the motor carrier control. Thus, even with subsidiary motor carriers, BN clearly fits within the single system doctrine.

GCA asks us essentially to reconsider the single system doctrine. We decline to do so in this proceeding. We continue to believe that regulatory scrutiny is not appropriate, under 49 U.S.C. §11343, where a noncarrier acquires control of an existing, single integrated carrier system. Such a situation involves only a change in stock ownership and the insertion of a new corporate entity at the top of an otherwise undisturbed chain of affiliated carriers. It does not involve the type of change in carrier relationships or competitive structure contemplated by section 11343.

In this connection, various intercorporate relationships involving BN have already been approved by the Commission. In such circumstances, no regulatory purpose would be served by requiring further approvals simply because BN is creating a holding company.

REOPENING THE BN-FRISCO MERGER

GCA and Minnesota argue that the formation of a holding company by BN will violate our decision authorizing the merger of the St. Louis-San Francisco Railway Company (Frisco) into BN. Burlington Northern, Inc.-Control & Merger-St. L., 360 I.C.C. 784 (1980) BN-Frisco). This merger was consummated on November 21, 1980. GCA alleges that the Commission was misled and was induced to misunderstand management plans for BN's financial structure. GCA asks us to enjoin the implementation of the holding company formation because it will jeopardize the financial strength of BN as a railroad.

GCA cites numerous passages in the BN-Frisco decision to support its proposition that we were misled. We have reviewed the record in the BN-Frisco case and the decision itself. We find no misleading representations in that case.

We imposed no conditions on our approval of the BN-Frisco merger concerning the retention of assets or the formation of a holding company. Our major concern in that case was not the corporate structure of BN, but whether carrier operations could be made more efficient and less costly through the merger without disrupting essential service. Id. at 934. We considered the cost savings to the railroad, the efficiencies which could be implemented by the railroad, and the harm to competition from the merger. All of these factors weighed in favor of the merger. We see no reason to reopen the BN-Frisco merger case.

JURISDICTION UNDER 49 U.S.C. §11348(a)

GCA contends that we can exert jurisdiction over the proposed holding company under 49 U.S.C. §11348(a) in this proceeding. This is not so. We may only assert jurisdiction over a noncarrier under section 11348 as a result of our authorization of a transaction under 49 U.S.C. §11343. Here, there is no transaction for us to approve under section 11343. Since no holding company existed at the time we approved the BN-Frisco merger, that transaction cannot serve as a basis for exerting jurisdiction under section 11348.

MORTGAGE BOND JURISDICTION

GCA and Minnesota assert that restrictions in two outstanding long term securities (Northern Pacific Railway Company Prior Lien Mortgage Bonds, 4 percent, due 1997, outstanding debt $81,699,000, and General Lien Mortgage Bonds, 3 percent, due 2047, outstanding balance $52,732,000) foreclose any transfer of assets to a holding company. Minnesota alleges that it is a holder of the 4-percent bonds due 1997, and further alleges that the proposed creation of a holding company and transfer of assets violate the terms of the bonds and impair its rights as a bondholder. GCA is apparently not a security holder and is thus without standing to assert rights in the mortgages.

These securities were issued in 1896, prior to Congressional action subjecting securities' issuance to our jurisdiction. With no jurisdiction over these securities, it would not be proper for us to interpret the securities terms.

For a holder of the mortgages to seek interpretation of the securities, his recourse would be to a court of competent jurisdiction, not this Commission.

REOPENING THE NORTHERN LINES MERGER

BRAC asks us to reopen the merger approved in Finance Docket No. 21478, Great Northern Pac.-Merger-Great Northern, 331 I.C.C. 228 (1967) (Northern Lines Merger), which created BN. It argues that condition 33 (discussed at 287-288 and imposed at 359) permits us to reopen that case to consider the impact on employees of the creation of a holding company. We disagree.

Condition 33 reserved jurisdiction for only 5 years for the specific purpose of either considering petitions for inclusion in BN, or cumulative and cross-over effects on other railroads from other consolidations being considered at that time. Clearly BRAC has not met the 5 year limitation: the Northern Lines Merger was consummated on March 2, 1970, and the reserved jurisdiction lost effect on March 2, 1975. Just as clearly, BRAC is not another railroad seeking inclusion or protection from cumulative or cross-over effects.

Under 49 U.S.C. §10327(g)(1) we may reopen a proceeding on our own initiative if there is material error, new evidence, or substantially changed circumstances. BRAC's petition presents none of these factors.

This action will not significantly affect either the quality of the human environment or the conservation of energy.

It is ordered:

1. The petitions are denied.
2. This decision is effective on the date served.

By the Commission, Acting Chairman Alexis, Commissioners Gresham, Clapp, Trantum, and Gilliam.

(SEAL)

AGATHA L. MERGENOVICH
Secretary

Interstate Commerce Commission
Washington, D.C. 20423

OFFICE OF THE CHAIRMAN

MAY 13 1981

Honorable Max Baucus
United States Senate
Washington, D.C. 20510

Dear Senator Baucus:

Thank you for your letter of April 27, 1981 requesting information regarding the proposed formation of a holding company to control Burlington Northern, Inc. (BN). Specifically, you asked four questions which are set forth below along with responses.

1. Has Burlington Northern filed any documents with the Commission concerning its holding company proposal? If so, please make copies of the submission and any ICC replies available for my use.

By letter of January 28, 1981 BN informed individual Commissioners of its intention to pursue the formation of a holding company to control the railroad. The letter also stated BN's conclusion that its proposed transaction did not require Commission approval. The letter is set forth in Attachment I.

No Commission response was made to BN's notice.

You may be interested to know that the General Committees of Adjustment, Burlington Northern, Inc., a labor organization involving BN employees, has filed a petition seeking an investigation of BN's compliance with the Commission's order authorizing the merger of BN and the St. Louis-San Francisco Railway Company in 1980. The petition alleges BN has failed to comply with terms of the decision allegedly requiring all BN assets to remain with the consolidated railroad company. BN replied to the petition on May 7, 1981. The petition (set forth in Attachment II) is presently under consideration by the Commission.

2. Has the Commission concluded that the holding company formation falls within the "one carrier exclusion?" If so, please supply a copy of any documents used in making that decision. If not, I would appreciate if the Commission or its staff could analyze ICC jurisdiction --with special focus on the fact that the new holding company would incorporate more than one carrier (i.e., two trucking companies and one railroad).

The Commission has not reached any conclusion regarding the applicability of the "one carrier exclusion" to the proposed BN transaction. The issue has been raised, and may be decided, in the proceeding instituted by the petition to investigate described in response to Item I above.

The Commission's jurisdiction over the acquisition of control of regulated carriers is contained in 49 U.S.C. §11343 (formerly section 5 of the Interstate Commerce Act). The language of that section does not reach the acquisition of control of a single carrier by a person that is not itself a carrier and which does not control another carrier. In

Louisville & J. B. & R. Co. Merger, 290 I.C.C. 725 (1955) and 295 I.C.C. 11 (1955), aff'd on other grounds Allegheny v. Breswick 353 U.S. 151 (1957), the Commission interpreted the statute as not conferring jurisdiction over the acquisition by a non carrier of control of the New York Central Railroad Company and its numerous carrier subsidiaries because they comprised a single established system. This case was the first statement of the "single carrier exclusion" to which you refer.

Since its announcement in the Louisville case the Commission has followed the doctrine in a number of cases involving the formation of rail holding companies. See Kansas City Southern Industries, Inc., Control, 317 I.C.C. 1 (1962); Katy Industries Inc.-Control-Missouri-K.T. R. Co., 331 I.C.C. 405 (1967); and Southern Pacific Transportation Co.-Merger, 334 I.C.C. 866 (1969). Motor carrier subsidiaries were involved in each of these proceedings. In the Southern Pacific case the Commission, Division 3, expressly found that the creation of a holding company to control a railroad which in turn controlled a motor carrier constituted a change in form, rather then substance, of the motor carrier control, 334 I.C.C. at 867, footnote 2.

3. Has the Commission assembled any information on the prospect that formation of the holding company might contravene the provisions of the Northern Pacific land grant bonds of 1977 and 2047? If so, please supply copies of the information and any determinations made concerning them.

The Commission in not empowered to enforce the provisions of the Northern Pacific bonds, and has not conducted a detailed study to determine whether the terms of the bonds would be violated by the creation of a holding company. The Commission conducted a general study of the structure of the railroad industry: Railroad Conglomerates & Other Corporate Structures, A Report to Congress As Directed By Section 903 of the Railroad Revitalization and Regulatory Reform Act of 1976, February 5, 1977. At page 52 of the report, the Commission stated its perception that the outstanding Northern Pacific bonds precluded the formation of a holding company for BN. A copy of the material in the report specifically related to BN is set forth in Attachment III.

BN's position in its Reply to Petition for Investigation filed May 7, 1981, is that the bonds may affect potential transfers of assets by the railroad, but do not obstruct the proposed formation of a holding company. The reply is Attachment IV.

4. Has the Commission prepared any analyses depicting the extent to which Burlington Northern's non-rail development activities have supported the capital and cash needs of the railroad portion of the corporation in the past? If so, please supply copies. If not, I would appreciate the Commission staff preparing a brief analysis of the issue.

The Commission has not conducted a specific study in this area, although, again, the Conglomerate report excerpted in Attachment III highlights the contributions of BN's natural resources assets.

Pursuant to your request our staff has reviewed the the impact of non-rail activities on Burlington Northern's financial posture. Non-rail income, primarily from natural resources, is extremely important to BN because it has enabled BN to maintain an A credit rating on its bonds by Moody's Investor Service. Any lower rating would have made it extremely difficult for the company to have done any non-equipment financing. For example, during the five years 1976 through 1980 the combined earnings available to cover fixed charges totaled $1,059 million. Fixed charges over the same five year period totaled $365 million, for a fixed charge coverage ratio of 2.9. Coverage of this magnitude is satisfactory to maintain an A rating. However, if non-railroad income is deducted from earnings available for fixed charges the $1,059 million figure would be reduced by $774 million to $2869 million, or less than the total fixed charges of $365 million. Rail operations performed better in 1980, generating a fixed charge coverage ratio of 1.30, but that ratio would not have supported an A rating. Additionally, the improved rail earnings might not have been possible without the large investments in rail facilities financed in part by funds from natural resources and from outside financing permitted by the A rating partly attributable to natural resource income. A summary of BN's financial performance of the period 1971 through 1980 is set forth in Attachment V.

I hope you will find these responses helpful and that you will call on me whenever I may be of assistance.

Sincerely,

Bruce N. Hatton
Director, Governmental Affairs

Attachment I

BURLINGTON NORTHERN

RICHARD M. BRESSLER
President and Chief Executive Officer

176 East Fifth Street
St. Paul, Minnesota 55101

January 28, 1981

Commissioner Thomas A. Trantum
Interstate Commerce Commission
12th & Constitution Avenue, N.W.
Washington, D.C. 20423

Dear Commissioner:

On January 26 the Board of Directors authorized the management of Burlington Northern Inc. to proceed with the formation of a holding company. The matter will be presented to our stockholders for their approval at their next annual meeting on May 14, 1981. Assuming the stockholders approve the recommendation of our Board of Directors, it is our intention to promptly create a holding company.

The Board of Directors also approved a new organizational structure for the Company providing for seven separate profit centers. The principal profit center will be the railroad. In addition, we will have trucking, air freight forwarding, and four separate nontransportation business profit centers.

During the last five years we have invested in excess of $2.1 billion in capital expenditures to expand and improve our rail service. Approximately $1 billion of this amount was spent to expand and improve our capacity to transport coal. We want to assure you that the formation of such a holding company will not in any way detract from our efforts to provide the necessary personnel and facilities to meet the needs of all of our rail shippers. However, we believe it important that each of our separate lines of business "stand on its own feet." We are confident that the formation of a holding company will ensure this result and that it will allow our nontransportation businesses to grow along with the railroad and thereby make an even larger contribution to the overall corporate enterprise and to the public interest.

Because Burlington Northern operates a single, integrated transportation system, the formation of such a holding company, under existing law, does not require Commission approval. However, because this is an important step in strengthening our management structure and providing better service, I wanted to personally inform each member of the Commission of our plans.

If you want any additional information, either Mr. Grayson, our Vice Chairman and President of our Transportation Division, or I would be happy to meet with you and discuss our plans in greater detail. If you have any questions, please feel free to call or write me.

Sincerely yours,

Interstate Commerce Commission
Washington, D.C. 20423

OFFICE OF THE CHAIRMAN

June 18, 1982

Honorable Max Baucus
United States Senate
Washington, D.C. 20510

Dear Senator Baucus:

Thank you for your letter requesting additional information in several areas relating to the March 26 hearing you chaired on rail merger policy and the Burlington Northern's formation of a holding company. I am enclosing the Commission's responses to your questions in order to supplement the hearing record.

If I can be of any further assistance, please contact me.

Sincerely yours,

Reese H. Taylor, Jr.

Reese H. Taylor, Jr.
Chairman

Responses to Questions Regarding Rail Merger Policy

The following responses explain the general policy of the Commission in railroad consolidation proceedings. As we have previously pointed out, however, application of this general policy in specific cases depends greatly on the facts of the particular case.

As I am sure you are aware, this Commission currently has pending a highly contested railroad consolidation, Finance Docket No. 30000 *et al.*, *Union Pacific Corporation and Union Pacific Railroad-Control-Missouri Pacific Corporation and Missouri Pacific Railroad* (MoP-UP proceeding). For that reason, it has been necessary to respond to several of your questions in very general terms to avoid commenting on issues that are before the Commission in a pending proceeding.

We expect to serve a decision in the *MoP-UP* case before the end of October 1982; that decision will discuss in depth a number of the issues raised in your questions.

1. Since railroad mergers can reduce competition and can encourage monopolization, do you agree that the effects of mergers must be scrutinized with care to assure that their alleged benefits cannot be secured by means short of merger and that the merger is fully justified in light of the Staggers Act policy favoring competition among railroads? If not, please explain.

Railroad consolidations can be beneficial to the public by enhancing competition and carrier efficiency; they can be potentially harmful by reducing competition and encouraging monopoly. The adverse economic effects that can result from lessening of competition or monopolization are of great concern and cause the Commission to spend considerable time scrutinizing the competitive effects of all consolidation proposals before reaching a decision on whether to approve a particular proposal. In light of the Staggers Act policy of encouraging competition, as well as our own experience that, for certain commodities and in certain markets, intramodal competition is essential, our evidentiary requirements have been structured to ensure that competitive impacts are fully addressed. These requirements include the filing of basic traffic, operating and financial data and the submission of information on competitive impacts in specific markets.[1] On the basis of detailed evidence of this nature, we are able to ensure that any consolidation proposal approved by the Commission, or approved subject to conditions, is consistent with the intent of the Staggers Act. As to whether the benefits can be achieved by other means short of consolidation, generally we believe that the Commission should not usurp the carriers' managerial judgment as to corporate structure or long-term strategies. Nevertheless, as stated in the Commission's consolidation policy statement,[2] we carefully consider whether the benefits claimed by applicants can be realized by means other than the proposed consolidation.

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[1] Ex Parte No. 282 (Sub-No. 3), Railroad Consolidation Procedures, 366 I.C.C. 75, decided February 19, 1982.

[2] Ex Parte No. 282 (Sub-No. 6), Railroad Consolidation Procedures, 363 I.C.C. 785, decided January 12, 1981.

2. Do you agree that effective competition among railroads is an essential safeguard against inadequate service or unreasonably high prices? If not, please explain.

We believe that effective competition among railroads is generally an essential safeguard against inadequate service or unreasonably high prices. In regard to certain commodities, such as bulk materials or shipments traveling relatively long distances which are transported almost exclusively by rail, effective competition among railroads provides the incentive to minimize costs and prices, provide good service, and seek out operational and marketing innovations. There are numerous other commodities and markets, however, where rail transportation is not the dominant mode of carriage. For these commodities and markets, we believe that our focus should be on preservation of effective intermodal competition to protect the public against inadequate service and unreasonable prices.

3. What actions do you think the Commission should take to encourage competition under the Staggers Act as an alternative to merger proposals which could result in a reduction in competition?

Various types of operational and service coordinations, other than consolidation, are available to carriers interested in providing alternative, competitive service to shippers. These arrangements include negotiation of trackage rights, joint use of facilities, run-through trains, and pooling. The carriers are fully aware of the availability of these options, and we believe the decision whether to use these alternatives should generally be left to the discretion of the carriers. We have encouraged these alternatives, however, by simplifying the procedures that must be followed to obtain regulatory approval or by liberal use of our exemption power. This is consonant with the goal of the Staggers Act to minimize the need for Federal regulatory control over the rail transportation system.

4. Would you favor mergers that have the prospect of rendering adversely affected railroads less able to compete? If so, would you favor conditions to preserve the ability of such railroads to compete and to serve shippers?

The Commission favors proposals that promote competition. With any consolidation proposal, however, there exists the possibility that one or more carriers will be less able to compete. Our primary concern in these situations is that competition be preserved, not individual competitors. An individual carrier's competitive problem may arise because of the efficiency of the merged system, rather than because of any anti-competitive conduct by the merged system. Accordingly, situations may occur in which the Commission would favor, without conditions, proposals that could adversely affect an individual carrier's ability to compete but do not substantially lessen competition. On the other hand, proposals that adversely affect a carrier's ability to compete, and thereby lessen competition, may be either denied by the Commission or conditioned so as to preserve the ability of carriers to compete and provide service.

5. Do you believe a rail merger should be approved where the resulting market power may impair the ability of competing carriers to continue providing adequate service to their shippers and communities? How should market power be measured in these circumstances?

The Commission would be greatly concerned and would carefully analyze any proposal that significantly increased the market power of consolidating carriers. Increases in market power potentially affect not only a competing carrier's ability to provide competition to the consolidated carrier but can also impair its ability to provide adequate transportation service to its shippers and communities. In light of these potential harms, the Commission's decision would necessitate a careful examination of reductions in service levels and alternative transportation services available to shippers and communities. Absent adequate alternatives, it is unlikely the Commission would approve a consolidation as proposed if increases in market power significantly affected service provided by competing carriers.

There are several methods for measuring market power. Perhaps the most common is analysis of market share data. This analysis consists basically of comparing the share of traffic of the consolidating carriers before the consolidation with the estimated market share after the consolidation. Generally, the higher the market share, the greater the market power. Other methods used include analysis of concentration ratios, independent routings and origination/termination coverage. In our opinion, each of these methods has the ability to produce reliable and valid results. Accordingly, we do not endorse any particular method.

6. In evaluating mergers, what consideration will be given to the probability that approval may necessitate consolidation of adversely affected carriers as the only means of survival?

The Commission recognizes that approval of consolidations will affect competitive relationships within various market areas. Since the decisions of the Commission focus on preservation of competition rather than individual competitors, the new post-consolidation environment may make it difficult for certain affected carriers to continue their operations in the same manner as prior to the consolidation. As changes occur, we believe it is incumbent upon affected carriers to develop appropriate competitive responses. For some, such as Norfolk and Western and Southern Railway Company, this may entail a consolidation of their own. For others, different responses such as operational agreements or new marketing strategies will be appropriate. In evaluating a consolidation proposal, we do not consider in detail what competitive responses an affected carrier can or should make. In our opinion, these responses are best left to corporate managements who are directly accountable to their own stockholders.

In its most recent merger policy statement, the Commission appears to be concerned with injury to competing carriers only where there is harm to "essential" services. The Commision has defined service as being "essential" if there is sufficient public need for the service and adequate alternative transportation is not available. Congress enacted the Staggers Act to preserve an "adequate economical, efficient and financially stable rail system." Section 11344 of the Act requires the Commission to consider the effect of the proposed transaction on the "adequacy of transportation" for the public.

7. Is it your view that a merger should be approved without regard to the effect on adequate rail service to shippers and communities if the Commission finds that service from other modes is available?

8. Does not the Commission policy of protecting only "essential" service conflict with the quoted sections of the Act? If your answer is "yes," will you initiate action to change the Commission policy? If your answer is "no," please explain how "essential" service equates with "adequate" rail transportation for the public.

In its merger policy statement, the Commission further states that conditions which are necessary to protect "the public" from anti-competitive consequences will not be limited by the "essential " services criteria.

9. Is it your view that the Commission, by conditions, should protect only that part of the public which may suffer anti-competitive consequences and disregard the impact of the merger on adequate, efficient rail transportation to other shippers served by the affected carrier?

Questions 7 through 9 deal with the Commission's examination of the potential effects of a proposed consolidation during its deliberations on a consolidation application. As you note, a primary concern of the Commission in any consolidation proceeding is the effect the proposed consolidation will have on adequacy of transportation to the public. In the process of balancing the public benefits against the harms which may result from the transaction, the Commission focuses on two possible harmful effects which could threaten the provision of adequate transportation: (1) the proposal's impact on the ability of carriers to compete effectively with the consolidated carrier; and (2) the ability of carriers to provide essential services to shippers and communities.

Therefore, it is not the Commission's policy to protect only essential services, but rather to examine the impact of a proposed consolidation on the adequacy of transportation to the public by balancing the public benefits against the harms and imposing conditions, where warranted, to ameliorate anticompetitive effects and possible harm to essential services resulting from the consolidation. As part of this examination, we consider whether the benefits could be realized by means other than consolidation.

In examining these two important elements relating to the adequacy of transportation, we must address the extent to which service from other modes provides an effective alternative to rail service. This assists the Commission in determining whether competition will exist after consolidation and whether essential services will be harmed. The mere existence of other modes of transport in a particular area, however, does not necessarily indicate the availability of an effective alternative to rail; we must examine the impact on the involved markets and commodities to decide whether service from other modes will be reasonably adequate before we decide to approve a rail consolidation.

If the Commission finds that a proposed consolidation is likely to have anticompetitive effects or result in harm to essential services, it is our policy to impose conditions to mitigate such harmful effects. For example, we will impose conditions to protect a carrier if its ability to provide essential services to its shippers is affected, the condition is related to the impact of the consolidation, and imposition of the condition will enable shippers to receive adequate service.

While mergers usually result in increased revenues for the merger applicants and improved service to some shippers and communities, there may be offsetting costs in the loss of revenue, efficiency and the service provided by adversely affected carriers. (Such is the major conclusion of the Still/Kornhauser study discussed at our hearing).

10. Will you seek to have the Commission require successful merger applicants to verify alleged benefits of their mergers and to have the Commission determine the overall effect of mergers on costs to the industry, other carriers, and service to the public?

As mentioned in my prepared statement and previous follow-up questions, the issue of verifying alleged benefits of a consolidation after its consummation is very complex. Many factors, such as changes in the economy and an ever-changing competitive situation, affect consolidation outcomes. While verification of projected benefits may be possible, we have doubts as to the usefulness of any such ex post consolidation benefit verification.

There are two reasons for this conclusion. First, Commission action as a result of an unfavorable verification analysis would not really be feasible since, once a consolidation has been consummated, there is little likelihood of reversing it. Second, although an ex post consolidation verification study could lead to some general conclusion about the viability of future consolidations, it is our experience that each consolidation application is so unique that general conclusions would provide very few benefits in a particular factual situation.

Under the circumstances, it appears that the cost of comprehensive post-consolidation analyses may far outweigh any benefits. However, as previously pointed out, the Commission's Bureau of Accounts does examine the subsequent performance of consolidated carriers as well as affected railroads as a part of the general oversight of the financial condition of the railroad industry.

11. If the Commission ascertains that other carriers and their service have been adversely affected, will you support Commission action to require the merged railroads to take action to eliminate or offset the losses?

As indicated in response to previous questions, a distinction must be made between the impact on "competition" and "competitors." It is the former that is of primary concern. If a proposal would adversely affect other carriers so as to substantially lessen competition, such a consolidation would be disapproved or approved subject to conditions. Once a consolidation has been consummated, there is little likelihood of reversing it. For that reason, the Commission carefully scrutinizes the competitive impact before taking action on any consolidation proposal. If the Commission subsequently determined, contrary to prior expectations, that the consolidation had adversely affected other carriers, resulting in inadequate service, consideration of the action to be taken would be determined on a case-by-case basis. The action would not take the form of indemnification to be paid by the merged system to compensate the affected carrier for its losses. Indemnification conditions to approval of consolidations can be anti-competitive by requiring the consolidated carrier to subsidize carriers who are no longer able to compete effectively in the marketplace. Indemnification conditions proposed after consummation are just as anti-competitive and are subject to grave legal obstacles. Moreover, it must be stressed, however, that in many instances, service from other modes provides an effective alternative to rail service.

12. Do you believe major mergers should be approved before audits have been made of previous major consolidations?

Our responses to question 10 and previous follow-up questions address this issue. Basically, since major consolidations all contain factual information unique to that particular consolidation, little would be gained by delaying consideration of one consolidation until audits of a previous one are completed. Moreover, such audits themselves would be highly suspect due to changing economic and competitive situations. Finally, the existing statutory time frames established for Commission action once a consolidation application has been filed would preclude the Commission from delaying action on an application until any sort of meaningful audit could be conducted.

In enacting the Staggers Act, Congress accepted the general contention that there will be a capital shortfall in the industry of between $16 billion and $20 billion. The Commission has authorized large railroad systems to be controlled by holding companies. If revenues derived through mergers are passed to holding companies for investment in non-transportation projects, the capital shortfall of the railroad industry could well be increased.

13. What conditions do you believe should be attached to mergers, or what other steps do you believe should be taken, to assure that benefits of mergers are retained in the railroad industry to foster sound, economic conditions in transportation and to benefit the shipping public?

As mentioned in my prepared statement, the Commission normally would impose conditions in a consolidation proceeding only if it is shown that essential services or competition would be affected by the consolidation. Generally, the Commission will impose conditions on a consolidation only if the condition is designed to enable shippers to receive adequate service, would not pose unreasonable operating or other problems for the consolidated carrier, and would not frustrate the ability of the consolidated carrier to obtain the anticipated benefits.

The imposition of conditions involves a balancing test--weighing the potential benefits to the public and other carriers against the possible harm to the public and the applicants. With regard to steps other than conditioning a consolidation, the Commission considers whether the benefits the applicants hope to achieve could be realized by some means other than the proposed consolidation that would result in less potential harm to the public.

With regard to the issue of holding companies, this has been addressed previously in our prepared statement and responses to earlier questions. As mentioned, the Commission's Bureau of Accounts does examine the subsequent performance of consolidated carriers as well as affected carriers as a part of the general oversight of the financial condition of the railroad industry.

U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General *Washington, D.C. 20530*

MAY 27 1982

Honorable Max Baucus
United States Senate
Washington, D.C. 20510

Dear Senator Baucus: Max,

In your letter to me of March 31 you requested that I furnish you further information about a recently-concluded Antitrust Division investigation of the Burlington Northern Railroad and that I also provide you with some specific recommendations for limiting the authority of administrative agencies to confer antitrust immunity. Because other agencies within the Administration should be consulted before I reply to your latter request, this letter responds only to your request for information about the investigation of the Burlington Northern. My answer to your second request will be sent to you as soon as it has been reviewed within the Administration.

As I indicated during my testimony before the Judiciary Committee on March 26, the Antitrust Division's investigation of the Burlington Northern ("BN") began in the early part of 1980, after we received certain information indicating that the BN, in an alleged attempt to prevent the Chicago, Milwaukee, St. Paul & Pacific Railroad (the "Milwaukee") from continuing to provide rail service in the states of the Northern Tier, might have deliberately violated the merger conditions imposed by the ICC in its Northern Lines merger decision. Because we feared that documentary evidence relevant to this matter might be destroyed as a result of a settlement agreement between the BN and the Milwaukee in a pending ICC proceeding, we immediately sent letters to the chief executive of the BN and the Milwaukee's trustee in bankruptcy asking them to preserve such documents voluntarily. Shortly thereafter Civil Investigative Demands (CID's) seeking literally hundreds of thousands of documents were sent to both the BN and the Milwaukee. As I explained in my testimony, many of the documents produced in response to these CID's were later reviewed by staff attorneys in the Department of Justice, who also conducted a number of interviews with shippers and former employees of both the BN and the Milwaukee. These attorneys also carefully analyzed the Northern Lines Merger proceeding and the various decisions of the Interstate Commerce Commission relevant to that proceeding.

As the investigation proceeded, these staff attorneys focused their inquiry in four areas: (1) possible BN violations of the ICC's merger conditions, (2) possible BN intimidation of shippers, (3) possible BN refusals to cooperate with the Milwaukee, and (4) alternative explanations for the Milwaukee's financial collapse. Each of these topics is discussed below.

1. Possible BN Violations of the Merger Conditions

The merger conditions that the BN was suspected of violating were the cumulative product of two ICC decisions--the "First Report" in which the Commission disapproved the proposed Northern Lines merger, and the "Second Report" in which the Commission reversed itself and allowed the merger to proceed. In the First Report the ICC found that a merger between the Great Northern and the Northern Pacific (the "Northern Lines") would drastically lessen competition between those railroads in an area extending from Minneapolis/St. Paul, (the "Twin Cities") across the Northern Tier of states, to the Pacific Coast. */ In its Second Report, however, the Commission concluded that "a properly conditioned merger--with a substantially strengthened Milwaukee--will actually enhance competition in the area and will be consistent with the public interest, notwithstanding elimination of such competition as exists between the two lines." **/ Thus, approval of the merger eventually turned on the fact that the conditions imposed by the Commission were expected to strengthen the Milwaukee as a competitior to the BN.

Of the conditions imposed by the ICC, the most important from a competitive perspective were conditions 23 and 24, which were designed to correct serious structural deficiencies in the Milwaukee's route system. Before the merger, one of the Milwaukee's main lines ran from Chicago, through the Twin Cities, across the Northern Tier, to the Pacific coast.

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*/ See 328 I.C.C. 460.

**/ 331 I.C.C. at 271; see also id. at 273, 275. In the course of its opinion, the Commission rejected the Department's contention that "reliance upon the strengthening of the CNW [Chicago & North Western] and Milwaukee as competitors to a merged Northern Lines would be a baseless ground on which to approve the merger." Id. at 275. Despite the Justice Department's appeal in this case, the Supreme Court affirmed the ICC decision and agreed with the ICC that a properly conditioned merger would strengthen the Milwaukee's competitive potential. 396 U.S. at 516.

Milwaukee had originally hoped this line would permit it to compete with the Northern Lines for transcontinental traffic. However, because the line stopped a few miles short of Portland, Oregon, the Milwaukee lost any chance to compete meaningfully for transcontinental traffic originating in, or destined to, Portland. A shipment originating in Portland, bound for Chicago, for example, would have to originate on one of the Northern Lines. Furthermore, the originating railroad would not voluntarily interchange any portion of this traffic to Milwaukee, and the originating carrier therefore would haul the traffic the entire distance to Chicago.

A similar problem beset Milwaukee on westbound movements. A shipper in Chicago, seeking to send traffic to Portland, would have the option of originating his traffic on either the Milwaukee or the Northern Lines. If he chose the Northern Lines, his shipment could travel directly to Portland without interchange. If he chose the Milwaukee, however, the shipment would have to be interchanged to the Northern Lines at some point before Portland. In most such cases, the Northern Lines insisted that such a westbound movement be interchanged no further west than the Twin Cities. Thus, the Milwaukee could take the movement only from Chicago to the Twin Cities before interchanging with the Northern Lines for delivery in Portland. Such a movement represented a "short haul" for the Milwaukee, and deprived it of the opportunity to earn substantial revenue.

In fact, even if the traffic from the east was destined to a point short of the coast, but still located on the Northern Lines, the same problem would arise. If the shipper in Chicago was sending traffic via the Milwaukee to a receiver located on the the Northern Lines in Billings, Montana, the shipment still had to be interchanged with the Northern Lines at the Twin Cities. The Milwaukee could not haul the traffic to a junction further west of the Twin Cities, such as Miles City, Montana, before interchanging with the Northern Lines. Again, Milwaukee was "short hauled," and deprived of substantial revenue. Finally, the fact that the Milwaukee did not reach Portland deprived it of connections with the Southern Pacific (SP) and the Union Pacific (UP). This meant it was precluded from participating in the extensive north-south traffic along the west coast.

In its First Report, the Commission took cognizance of the severe limitations under which the Milwaukee labored:

> The limitations on Milwaukee's routes west of Twin Cities and Sioux City, together with the fact that Milwaukee is short hauled at the Twin Cities gateway on a large volume of traffic, has severely

> limited Milwaukee's traffic potential, and has impaired its competitive position in relation to applicant railroads. Consequently, Milwaukee's participation in substantial movements of transcontinental traffic over its lines west of Twin Cities is limited to that which moves to or from a point served directly by the lines of Milwaukee and to those movements within Mountain-Pacific territory to points beyond its lines, which originate or terminate at local points on its lines not served by applicant railroads. On the other hand, the ability to participate in traffic to and from Oregon and California has been an important factor in the ability of the Northern Lines to improve their relative participation in traffic over their lines west of Twin Cities. Numerous shippers have indicated that the rate and service limitations on Milwaukee routes have prevented them from making full use of the latter's service potential, to their detriment as well as the Milwaukee's. */

Of the conditions that the Commission adopted in order to allow the Milwaukee to overcome this disability, the most significant is condition 23, which states:

> 23. Nuco [Burlington Northern] shall publish and file appropriate tariffs and routing schedules to be effective on and after the date of consummation of the merger, providing for the opening of junctions and gateways at Linton and Fargo, N. Dak., and Miles City, Judith Gap, Great Falls, Bozeman, Butte, and Missoula, Mont., and Spokane, Seattle, and Tacoma, Wash., with respect to traffic moving through said junctions, at the lowest applicable rates available via the Twin Cities and Sioux City gateways (on a reciprocal basis, with the Milwaukee affording equal privileges to Nuco) with just and reasonable divisions thereof as may be agreed upon, or fixed by this Commission if such carriers cannot so agree, and the Milwaukee shall, on traffic obtained pursuant to this condition or those in paragraph 24, below, open or keep open in similar manner its junctions at Twin Cities, Sioux City, and Council Bluffs with North Western, and on traffic obtained pursuant to this condition or those in paragraph 24, below, open or keep open in similar manner its junction at Twin Cities with Soo Line. **/

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*/ 328 I.C.C. at 493.

**/ 331 I.C.C. at 887 (emphasis added).

This condition thus "opened" the eleven named gateways to the Milwaukee. As a result, according to the Commission, the "Milwaukee could solicit for its longest practical haul over its lines west of Twin Cities or Sioux City [for] traffic which must now [before the merger] be surrendered or received at those points." */ Thus, for example, a freight car moving from Chicago to Portland, which before the merger would have to have been exchanged only at Twin Cities or Sioux City, could, after the merger, be interchanged between the BN and the Milwaukee at any one of the eleven western gateways if so requested by a shipper. Significantly, the condition was made reciprocal. That is, the BN had the same opportunity to solicit for its long haul over the eleven gateways as did the Milwaukee.

The Commission also attached several other conditions to the merger in order to improve the Milwaukee's competitive posture. Condition 24(a) provided for the Milwaukee's access to Portland by giving the Milwaukee the right to run its trains over 47 miles of the BN's track from Longview Junction, Washington, to Portland. **/ This, in turn, allowed the Milwaukee to compete with the BN on transcontinental routes, as well as to connect with north-south service along the west coast. ***/ Condition 24(b) allowed the Milwaukee to connect directly with the Canadian railroads by granting it trackage rights over the BN's tracks between Renton, Washington, and Snohomish, Washington, and between Everett, Washington, and Bellingham, Washington. ****/ Condition 24(c) allowed the Milwaukee to reach Billings, Montana, which at the time was served only by the Northern Lines. *****/

The Supreme Court assessed the conditions as follows:

> The conditions imposed by the Commission's Second Report will ... substantially enlarge the Milwaukee's competitive potential between St. Paul and Minneapolis and the West Coast due to enlargement of its long-haul capability. Shippers will be afforded more flexible service. Another condition attached to the Commission's approval will permit the Milwaukee to run lines from its present western terminus into Portland,

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*/ 328 I.C.C. at 449.

**/ Such rights, which are occasionally ordered by the ICC in merger proceedings, are known as "trackage rights."

***/ 328 I.C.C. at 494; 331 I.C.C. at 280-283.

****/ 328 I.C.C. at 494.

*****/ Id.

> giving it a link with the Southern Pacific. All this will enable the Milwaukee to compete with the Northern Lines for east-west traffic and some north-south traffic as well as linkage with Canadian carriers to the north, which was previously the exclusive domain of one or both of the Northerns. Other conditions of lesser consequence will buttress the newly designed competitive posture of the Milwaukee. */

The allegations that the BN violated these conditions fall into two basic categories: (1) that the BN used condition 23 improperly to maximize its "long hauls" and (2) that on occasion the BN refused to honor the open gateways requirement.

The first of these two allegations was essentially founded on a group of documents that the Milwaukee obtained from the BN in the course of discovery that the Milwaukee conducted on the BN as part of an ICC proceeding. These documents suggested that following the Northern Lines merger, the BN attempted to maximize its "long hauls" on the shipments that were interchanged between the BN and the Milwaukee at the eleven gateways, i.e., that the BN sought to have shippers designate the BN, rather than the Milwaukee, as the railroad that was to haul their shipments the furthest. Railroads generally desire "long hauls" because, when more than one railroad is involved in a movement, the revenue from that movement is usually allocated among the participating railroads pro rata according to the distance each railroad carried the particular shipment.

Our investigation confirmed that, in fact, the BN did make a concerted effort to maximize its long hauls, and, as result in many cases caused the Milwaukee to be "short hauled." Our investigation also revealed, however, that, contrary to the allegations, this conduct by the BN was entirely consistent with the ICC's merger conditions. In fact, the express language of condition 23 clearly states that it is a reciprocal condition. Thus, while condition 23 obligated BN to open eleven gateways to Milwaukee, it also permitted either railroad to ask shippers to give it the long haul. Consequently, under condition 23, Milwaukee could go to a shipper located on the BN lines in Billings, and ask that shipper to route his shipment via the BN to Billings, thence via the Milwaukee to Chicago. The BN, however, was accorded a comparable privilege. In its first report, the Commission explained how the condition would work, and made clear its reciprocal nature:

> At the present time, shipments originated by either of the Northern Lines at points on their respective lines west of Twin Cities, receive a long haul over their

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*/ 396 U.S. at 516.

> lines to the Twin Cities and are there interchanged with a connecting line designated by the shipper. Milwaukee seeks to require the New Company to join with it in establishing new gateways so that Milwaukee could move shipments originating on the New Company's lines west of the 11 gateways over Milwaukee's lines either as a bridge or terminating carrier. *Similarly, the New Company would be able to shorthaul Milwaukee by taking a shipment, originating on Milwaukee west thereof, at the gateway, either as a bridge or terminating carrier*. The shorthaul proposal would apply both eastbound and westbound. In other words, the condition contemplates that a shipper could route traffic at joint through rates with interchange between the Milwaukee and the New Company at Twin Cities or Sioux City, or at any one of the 11 North Dakota, Montana or Washington gateways. */

Thus, efforts by the BN to short haul the Milwaukee and to keep as much long haul revenue for itself as it could are fully consistent with the terms of Condition 23, and certainly do not provide any basis to conclude that in so acting, the BN violated the ICC's merger conditions.

A second aspect of the allegation that the BN violated the merger conditions is the claim that in some cases the BN refused to interchange shipments with the Milwaukee at the eleven gateways. Our analysis of the documents did show that in several isolated instances the BN may have arguably violated the merger conditions in that manner. However, the documents we saw showed only a handful of such possible BN violations. Furthermore, in most of these instances it is impossible to determine unequivocally whether the BN really violated the conditions or not. The Milwaukee, although aware of all potential violations, took only one complaint to the Commission alleging the BN's failure to live up to the merger conditions. Milwaukee lost this case. **/ Although such violations could give the Milwaukee grounds for seeking corrective action by the

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*/ 328 I.C.C. at 498 (emphasis added). See also *id*. at 499: "[I]t would permit Milwaukee to solicit for its longest practical haul .... Correspondingly, New Company would have the same opportunity"; and *id*. at 500: [T]he gateways conditions would be reciprocal. Thus, New Company could shorthaul Milwaukee."

**/ *See*, *Chicago, Milwaukee, St. Paul & Pacific Railroad Co., Richard B. Ogilvie, Trustee* v. *Burlington Northern, Inc.*, I.C.C. Docket No. 37332 F.

ICC, the violations, if they were violations at all, were too isolated and minor to constitute proof of any intent by the BN to drive the Milwaukee from the Northern Tier.

2. BN Intimidation of Shippers

A second major allegation against the BN that we investigated was the claim that the BN intimidated shippers to prevent them from giving business to the Milwaukee. However, neither our examination of the documents nor our interviews with shippers could substantiate this allegation. In fact, some of the shippers we interviewed stated that they preferred to give their shipments to the BN because it offered better service.

3. BN Refusals to Cooperate With the Milwaukee

Although our investigation focused primarily on the specific allegations that the BN refused to honor the merger conditions and attempted to intimidate shippers who utilized the Milwaukee's services, we also considered the possibility that the BN might have engaged in other types of prohibited practices that were not specifically alleged. In particular, we gave consideration to the possibility that refusals by the BN to coordinate use of its tracks and facilities with the Milwaukee arguably might have involved an antitrust violation, if such a refusal occurred in cases where the proposed coordination would be mutually beneficial to both railroads. For example, if, by jointly operating over a single track instead of two separate tracks, both railroads could reduce their expenses without giving either road a competitive advantage over the other, the motivation for BN's refusal might well be, not the preservation of its existing competitive advantages, but a desire to weaken its competitor by denying it the benefit of any possible cost savings. Significantly, the documents we reviewed indicate that in cases where a proposed coordination appeared to be mutually beneficial, the BN was willing to cooperate with the Milwaukee.

4. Alternative Explanations for the Milwaukee's Financial Collapse

Besides investigating the competitive behavior of the BN, the Department also explored alternative explanations for the Milwaukee's financial collapse. This aspect of our inquiry disclosed that the most probable explanation for the

Milwaukee's withdrawal from the Northern Tier was the almost continual unprofitability of its western lines (the "Pacific Coast Extension").

The Pacific Coast Extension (PCE) was built early in this century at a cost of $250 million--$205 million more than originally expected. This extraordinary cost increase continually handicapped the Milwaukee. In fact, industry analysts believed that this 1,771-mile line, together with its branches, never secured sufficient density to earn a market rate of return on investment. */ Likewise, the special master appointed by the reorganization court to report on the Milwaukee asserted that the PCE never even produced a sufficient return to service the debt of its construction. **/ Once it became saddled with this costly burden, the Milwaukee's financial condition deteriorated quickly until, in 1925, it went into receivership. The ICC found that the construction of the PCE was the chief cause of this bankruptcy. ***/ The carrier emerged from bankruptcy in 1928. However, it labored under continual annual deficits until 1935, when it again collapsed into bankruptcy. This time, it did not emerge from bankruptcy for ten years. ****/

The costs of the Pacific Coast Extension had a financially devastating effect on the railroad in the 1970's as well. Although the Milwaukee managed to show positive rail net income in five of the ten years preceding the Northern Lines merger, this was achieved in part by postponing necessary maintenance for its tracks and equipment. A special master reported to the reorganization court that the Milwaukee survived the 1960's (and until 1977) "only through an increasingly extensive program of deferring such maintenance." */

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*/ Conant, "The Future of the Milwaukee Road," 45 ICC Practitioner's Journal 280-281 (1977-1978).

**/ Report of Special Master, Milton H. Gray, including Findings of Fact, Conclusions of Law, and Recommendations, on the Trustee's Application for Abandonment of the Pacific Coast Extension, at 4 (February 29, 1980) (hereinafter Special Master).

***/ 131 I.C.C. 615, 668. See also Richard B. Ogilvie, Trustee of the Property of Chicago, Milwaukee, St. Paul and Pacific Railroad Co.--Abandonment--Portions of Pacific Coast Extension in Montana, Idaho, Washington, and Oregon, ICC docket AB-7 (Sub-No. 86) at 4 (served January 30, 1980) (hereafter PCE Abandonment).

****/ PCE Abandonment at 7.

The eventual result of this program of deferred maintenance was worsened (*i.e.*, slower) service, and this gradually caused shippers to turn to the only alternative to the Milwaukee--the BN. Worthington L. Smith, then the Milwaukee's President, testified about this dilemma before the ICC:

> [O]ur failure on a day-to-day basis to function in a manner attractive to shippers who had the ability to choose competitively between us and the BN has resulted in the problem of lessened traffic which, in turn, reduced our ability to produce the kind of system which would attract increased traffic. **/

Similarly, the Commission noted that the foregone maintenance in the 1960's and 1970's caused the Milwaukee's freight service time between Chicago and Seattle to jump from 53 hours to 130 hours. ***/ Likewise, the Milwaukee's transit time between St. Paul and Tacoma in 1980 was 87 hours, 45 minutes, while the BN ran the comparable route to Seattle in 48 hours, 40 minutes. ****/ Not only did this slower service drive away time-sensitive shippers, it caused a lower return on Milwaukee's equipment (because the cars made fewer trips per year) and forced the company to rent other equipment, thereby further increasing its costs. Eventually, the burden of the PCE once again became too great for the Milwaukee to bear and, as you know, in 1977 the Milwaukee was, for the third time in this century, forced to seek protection under the bankruptcy laws.

In sum, the Department's investigation of the Burlington Northern's competitive behavior toward the Milwaukee failed to disclose any evidence of possible antitrust violations. Although there was some indication that the BN might have committed isolated breaches of some of the ICC-imposed merger conditions, the effect of any such violations on the financial standing of the Milwaukee was *de minimis*. Nor was there any material evidence that the BN intimidated shippers or otherwise violated the antitrust laws. Instead, our investigation disclosed that the Milwaukee's financial plight was essentially due to the Pacific Coast Extension's lack of profitability.

I hope that the foregoing information about the Department's investigation will be of assistance to you.

Sincerely,

Bill

William F. Baxter
Assistant Attorney General
Antitrust Division

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*/ Special Master at 5.

**/ Testimony of W. L. Smith in Finance Docket No. 21478 (Sub-No. 4), at 6.

***/ PCE Abandonment at 22.

****/ *Id.* at 20.

United States Court of Appeals
FOR THE EIGHTH CIRCUIT

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Brotherhood of Railway Carmen,
Burlington Northern Joint
Protective Board; Allied
Services Division, Brotherhood of Railway and Airline
Clerks; Brotherhood of Railway Signalmen; General Committee of Adjustment, United
Transportation Union No. 386,
Burlington Northern Inc.;
Yardmasters of America;
Brotherhood of Locomotive
Engineers, Burlington
Northern Inc.; and International Brotherhood of
Electrical Workers,

Petitioners,

v.

Burlington Northern Inc. and
United States of America,

Respondents.

On Petition for Review
of an Order of the
Interstate Commerce
Commission.

Submitted: December 15, 1981

Filed: February 17, 1982

Before LAY, Chief Judge, HENLEY and ARNOLD, Circuit Judges.

ARNOLD, Circuit Judge.

This is a petition for review of a decision of the Interstate Commerce Commission. On April 30, 1981, several labor unions representing Burlington Northern employees filed a petition with the Interstate Commerce Commission requesting that Burlington Northern Inc. (BN), then a common carrier, be prevented from transforming itself into a holding company. The request was based, in part, on the allegation that BN had misled the Commission in an earlier proceeding in which the Commission had unanimously approved the merger of Burlington Northern and the St. Louis-San Francisco Railway Company. See Burlington Northern, Inc.-Control and Merger-St. Louis-San Francisco Railway Company, 360 I.C.C. 788 (1980), to which we shall refer as the "merger order." Petitioners also claimed that formation of the holding company violated the merger order and that authorization by the Commission was required under various provisions of the Interstate Commerce Act, 49 U.S.C. §§10101 et seq., before the holding company could be formed. On June 5, 1981, in the decision we are now asked to review, the Commission denied appellant's petition. The Commission found that BN had not violated the merger order and that the holding-company transaction was not one which required the approval of the Commission. Great Northern Pacific & Burlington Lines, Inc.-Merger, etc.-Great Northern Railway Company, ____ I.C.C. ____ (1981). This petition for review followed.

The petitioners urge the following arguments: (1) that the Commission erred when it found that the formation of the holding company did not violate the merger order; (2) that the Commission erred when it determined that certain bond indentures did not forbid the formation of a holding company; and (3) that the Commission erred in holding that the Interstate Commerce Act did not give it jurisdiction to approve or disapprove the formation of the holding company.

For reasons to be explained below, we reject the first two of these arguments and remand for further proceedings with respect to the third.

I.

In 1977 a final agreement was reached to merge Burlington Northern with the St. Louis-San Francisco Railway Company (the Frisco), which, as we have noted, was approved by the Interstate Commerce Commission in 1980. The Commission's decision was affirmed in *Missouri-Kansas-Texas R.R. v. United States*, 632 F.2d 392 (5th Cir. 1980), *cert. denied*, 101 S. Ct. 3004-05 (1981).

BN is a diversified natural-resources company as well as a transportation company. It owns considerable non-transportation assets, including coal, minerals, and timber. As a common carrier, BN had a limited ability to develop fully these non-transportation assets, because it could issue securities only with the approval of the Interstate Commerce Commission, and then only for a carrier purpose. See 49 U.S.C. §11301(d)(1). In an effort to attain greater flexibility in the development of these assets and to expand its non-transportation business, BN's Board of Directors recommended a corporate restructuring which would result in the formation of a holding company. It was their judgment that the holding company would not be considered a carrier, leaving it free to issue securities associated with its non-transportation assets for any proper corporate purpose. On May 14, 1981, following a federal district court's denial of petitioners' request for a preliminary injunction,[1] BN shareholders overwhelmingly approved the formation of the holding company, by which BN then became a wholly owned subsidiary of the publicly owned holding company. The transaction did not, however, effect any transfer of assets from Burlington Northern Railroad to the holding company.

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[1] *Brotherhood of Railway and Airline Clerks, Consolidated System Board of Adjustment 46 v. Burlington Northern Inc.*, 513 F. Supp. 1023 (D. Minn.), *appeal dismissed*, 664 F.2d 294 (8th Cir. 1981) (per curiam).

II.

Petitioners' first argument is that the Commission erred in holding that the formation of the holding company did not violate the Frisco Merger Order, and therefore, that it acted arbitrarily by not reopening the Frisco proceeding. This argument relies on certain language contained in the Frisco Merger Order and other language contained in an appendix to the order summarizing BN's facilities. The cited language from the order is as follows:

> The financial strength of BN is due in large measure to the existence and development of its nonrail assets. *

360 I.C.C. at 798.

> Applicants contend that the merged rail company would be enhanced by BN's nontransportation operations. . . . Applicants state that such nontransportation operations (particularly those involving timber and coal) permit BN to commit internally generated funds to capital intensive projects required by its rail service.

Id. at 814.

> Applicants also state that Frisco's financial base would be expanded, be-

> cause BN's internally generated funds from nontransportation activities would be available to the merged system.

Id. at 819. From the appendix petitioners cite the following:

> Those in a position to control a railroad's actions can divert the carrier's income, property, and other assets for nonrail purposes. This opportunity exists to a significant degree when a parent holding company controls the railroad.
>
> BN will not be in a position to form a holding company for many years due to bond indenture restrictions. Therefore, the opportunity for a diversion of assets to other sources does not presently exist. Also, the current management of BN appears to be fully dedicated to railroad operations.

Id. at 992-93. In petitioners' view these passages constitute an unequivocal prohibition against BN's formation of a holding company. The Commission, however, read its order differently, and found that it did not condition its approval of the merger upon BN's agreement not to form a holding company. The Commission also found that it had not been misled by BN.

The issue is whether the Commission erroneously interpreted its own prior order authorizing the merger. The scope of our review in such a situation is quite narrow. An interpretation "of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong . . . ." *Red Lion Broadcasting Co. v. Federal Communications Commission*, 395 U.S. 367, 381 (1969) (footnote omitted). *A fortiori*, great weight should be given here to an agency's interpretation of its own orders, and we, as a ~~review~~ing court, should follow that interpretation unless it is entirely unreasonable. Petitioners make no such showing here.

The Frisco Merger Order and Appendix contain two sections which refer specifically to conditions to be imposed on the Frisco merger, 360 I.C.C. at 950-58, 1179-82. No mention is made of a bar against the formation of a holding company. Thus, the order, on its face, does not impose the restriction alleged by petitioners. The passages on which petitioners base their argument are only general statements of expectation, not conditions imposed on the parties to the merger. The Commission's primary concern was not the corporate structure of BN, but whether the merger was likely to result in operations that were more efficient and less costly with no disruption in service. See 360 I.C.C. at 934-50. In addition, the bond-indenture restrictions, which the Commission took to be a primary guarantee against diversion of nonrailroad assets, are, so far as this record shows, still in full force and effect. The mere formation of a holding company does not put BN in a position to violate these restrictions with impunity, and we have no reason to suppose that it will attempt to do so.

III.

These bond-indenture restrictions are the basis for petitioners' second argument. Petitioners contend that BN's Prior Lien and General Mortgage bonds issued in 1896 contain restrictions that preclude the formation of the holding company. BN concedes that the bonds may restrict the transfer of certain assets to a holding company, but argues that they do not bar the formation of such a company. Petitioners concede in their brief, p. 51, that they do not own any of the bonds in question here. Based on this fact the Commission concluded that the petitioners lacked standing to assert any rights under the bond indenture.[2] We agree.

IV.

Petitioners argue finally that whatever the meaning of the merger order, or the significance of the bond restrictions, the Commission had jurisdiction under the Interstate Commerce Act to approve or disapprove BN's creation of the holding company. Section 11343(a) of the Act, 49 U.S.C. §11343(a), lists the "transactions involving carriers" that are subject to Commission approval.[3] The portion of §11343(a) relevant here provides for prior approval by the Commission where there is a proposed "acquisition of control of at least 2 carriers by a person that is not a carrier."[4] 49 U.S.C. §11343(a)(4). Because BN's subsidiaries include several separately incorporated rail and motor carriers, petitioners asserted that the holding-company transaction would result in control of "at least 2 carriers." The Commission disagreed. The Commission considered BN a single, integrated transportation system, even though it is made up of several separate corporations. Under this "single system doctrine" BN was considered to be, in effect, one carrier.

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[2] The Commission found that the State of Minnesota, a petitioner below but not a party to this petition for review, was a holder of some of the Prior Lien Mortgage Bonds. The Commission concluded that the State's interest in the bonds was not a basis for jurisdiction because the bonds were issued in 1896, long before congressional action subjecting securities' issuance to the jurisdiction of the Interstate Commerce Commission. The State of Minnesota has not petitioned us for review of this action, and we express no opinion as to the correctness of the Commission's view on this issue.

[3] The transactions covered by §11343(a) are as follows:

> (1) consolidation or merger of the properties or franchises of at least 2 carriers into one corporation for the ownership, management, and operation of the previously separately owned properties.
>
> (2) a purchase, lease, or contract to operate property of another carrier by any number of carriers.
>
> (3) acquisition of control of a carrier by any number of carriers.
>
> (4) acquisition of control of at least 2 carriers by a person that is not a carrier.
>
> (5) acquisition of control of a carrier by a person that is not a carrier but that controls any number of carriers.
>
> (6) acquisition by a rail carrier of trackage rights over, or joint ownership in or joint use of, a railroad line (and terminals incidental to it) owned or operated by another rail carrier.

This interpretation of §11343(a)(4) (formerly 49 U.S.C. §5(2)(a)) -- that acquisition of a single established carrier system, even if comprised of a number of corporate entities, is not subject to Commission jurisdiction -- has been followed consistently by the Commission for the last 25 years. See Louisville & Jefferson Bridge & R. Co. Merger, 295 I.C.C. 11 (1956), aff'd on other grounds sub nom. Alleghany Corp. v. Breswick & Co., 353 U.S. 151 (1957).[5] Although this interpretation of the phrase "2 carriers" is by no means the only possible one, nor necessarily the construction we would adopt if we were free to decide the question independently, it is not unreasonable, and we therefore defer to the Commission's view of its own governing statute, especially since this construction has been consistently adhered to over a long period of time.

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[4] Petitioners also argue that the holding company should be considered a carrier and thus subject to the Commission's jurisdiction under §§11301(b)(1) and 11348(b). This contention is meritless. At the time the holding company acquired control of BN Railroad it was not engaged in any business, it did not propose to become a carrier, and it did not control any carriers. We also reject petitioners' reliance on §11348(a). That provision would come into play only if the holding-company formation is a transaction listed in §11343(a).

[5] For examples of this same interpretation, see Southern Pacific Transportation-Merger, 334 I.C.C. 866, 870-71 (1969); Katy Industries, Inc., Control-Missouri-Kansas-Texas R. Co., 331 I.C.C. 405, 411-12 (1967); Kansas City Southern Industries, Inc., Control, 317 I.C.C. 1, 3-4 (1962).

Petitioners argue, however, as a factual matter, that the Commission erred when it found that the holding-company transaction resulted in the "acquisition of control" of a single carrier only. They point to BN's relationship with several terminal and switching railroads in which BN owns less than a 50% interest.[6] These corporations are unquestionably outside BN's corporate family, and thus are not a part of the single, integrated system. Petitioners argue that an assessment of the degree of control in the corporate context involves many factors, and that actual control of a corporation is possible through ownership of less than 50% of the stock. So, they argue, BN is likely to have actual control of at least one or more of these terminal and switching railroads, and therefore the holding company transaction is an "acquisition of control of at least 2 carriers by a person that is not a carrier," 49 U.S.C. §11343(a)(4).

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[6] In the verified statement of William F. Thompson, Senior Vice President - Operations, Burlington Northern, Inc., BN acknowledged its interest in the various switching and terminal companies. Mr. Thompson testified:

> BN also owns various interests in certain switching and terminal companies such as The Belt Railway of Chicago (7.7%), Pueblo Union Depot (25%), St. Paul Union Depot (40%), TRRA (12.5%), Illinois Terminal Railway Company (18%), Kansas City Terminal Railway Company (8.3%), Denver Union Terminal Company (16.7%), Houston Belt and Terminal Railway Company (12.5%), Wichita Union Terminal Company (33.3%), and several others, but does not control, manage, or set policy for any of these companies. BN simply has representation on the Board of Directors of these companies. These carriers are not a part of the BN system although extensive use is made of their facilities by BN in the course of the transportation service it performs for the shipping public.

Petitioners' Appendix p. 79.

The respondents contend that by their very nature the terminal and switching railroads are not subject to control by any one carrier, but are more properly viewed as "partnerships" in which no one partner has the ability to control the destiny of the corporation. These concerns, we are told, are jointly owned and operated by competing linehaul carriers and are located at points of junction in order to serve the limited function of allowing the free interchange of rail traffic. BN is said not to be in a position to control any of these carriers because the inherent nature of the companies and of the service they provide makes control by any one carrier impossible.

The respondents' argument on this point may be well taken, but we are at a loss to find any support for it in the Commission's order rejecting petitioners' request for investigation of the formation of the holding company. There is no mention of this issue in the Order of June 5, 1981. Respondents suggest that petitioners' argument was implicitly rejected by the Commission's otherwise detailed finding that BN was a single, integrated system. This implicit rejection is also said to be supported by the Commission's straightforward use of the single-system doctrine to find a lack of §11343 jurisdiction in several similar cases where holding companies were created from railroads. See Southern Pacific Transportation-Merger, supra; Katy Industries, Inc., supra; Kansas City Southern Industries, Inc., supra. This analysis leaves us unsatisfied. We, as an appellate court, stand ready to defer to the Commission on findings of fact and, to a more limited extent, on conclusions of law. Here, however, the Commission made no specific factual findings or conclusions of law on this issue. We are unwilling to speculate as to the Commission's intentions, and therefore remand for further findings.

We intimate no opinion as to the extent or nature of the future proceedings necessary to resolve this issue. As respondents have suggested, the Commission only recently concluded an extensive, two-year study of BN and its subsidiaries in the Frisco merger case. The Commission may be able to take administrative notice that BN's interests in the terminal companies do not constitute control so as to confer jurisdiction under §11343(a)(4). We in no way intend for the Commission to ignore what it already knows. We insist only that the Commission tell us what it knows, so that we can then, if another petition is filed by any party, decide whether the Commission's conclusion is a permissible one.

In sum, we hold that the Commission was within its rights in holding that the formation of the holding company did not violate the Frisco Merger Order, and that the union petitioners have no standing to assert a violation of BN's bond indentures. We also sustain, in general, the Commission's use of the single-system doctrine to define its authority under 49 U.S.C. §11343(a)(4). The order denying the unions' petition for investigation will be vacated, however, and the cause remanded to the Commission, for such further proceedings as may be necessary to determine whether BN's interests in terminal and switching companies take this case out of the single-system doctrine and give the Commission jurisdiction over the formation of the holding company.

It is so ordered.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

CRS Main File Copy

KENNETH R. GRAHAM

S-80 12912

Rail-Based Holding Companies: A View of Some Indicators of Strategy, Management Change, and Financial Performance

INTRODUCTION

The formation of rail-based holding companies was a distinctive business phenomenon of the 1960s and early 1970s. By 1972, the population of such entities stood at sixteen, and encompassed a significant portion of the nation's Class I railroad mileage.[1] This article focuses on a study of selected indicators of economic performance, management change, and corporate strategy in rail-based holding companies. The study specifically sought to:

1. Identify the relationship between rates of return on railroad assets and the decision to diversify.
2. Examine the degree to which holding companies headed by rail-oriented presidents have engaged in non-rail diversification.
3. Examine rail-based holding company performance subsequent to non-rail diversification.

HOLDING COMPANY DIVERSIFICATION PATTERNS

The degree of diversification into non-rail lines of business varies markedly among rail-based holding companies. Of the holding companies considered here, four have pursued diversification to the point where railway operating revenues represent 40 percent or less of total corporate (i.e., holding company) revenue. These firms, together with one which derives less than two-thirds of its revenue from rail operations, are classified in Table I as diversified firms. In contrast, rail revenues have continued to dominate the total revenues of other rail-based holding companies, i.e., those categorized as non-diversified in Table I. Let us now look at some possible causes of these differing patterns of diversification.

POOR INITIAL RAIL RETURNS

Rumelt, a researcher in the field of management strategy, suggests that diversification reflects an effort to "escape" from inadequate earnings.[2] Data presented in Table II show that, during the initial period of time focused upon in this study (1957-1960), inadequate returns were a reality for the five railroads which diversified (as categorized in Table I). The five firms that remained non-diversified (as categorized in Table I) throughout the period of the study

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earned average returns on total assets which exceeded the returns on a "riskless" investment alternative. Indeed, as shown in Table II, the diversified firms, prior to their diversification, earned rates of return which were less than two-thirds of that which could have been earned from an alternative riskless investment (i.e., a 30-year U.S. Treasury bond).

CHANGES IN MANAGEMENT, PERSONNEL, AND CORPORATE STRATEGY

In a recent book on railroad management, D. Daryl Wyckoff suggests that railroad chief executive officers are rail-operations oriented, and are imbued with a perspective limited to the railroad industry, its customers, and it regulators.[3] Raymond E. Miles and Charles C. Snow, researchers in the field of management strategy, contend that firms with strong industry orientations, such as railroads, have managements that are resisting changes in the competitive economic environment and defending their industry by attempting to maintain the *status-quo.*[4] Such firms are dominated by an orientation which encourages striving for production efficiency and cost control at the expense of marketing, technological innovation, and scanning or monitoring of the corporation's external environment for strategic opportunities. Wyckoff cites promotion from within, promotion on the basis of seniority, the dominance of the rail-operations-oriented career ladder, and the resulting long career tenure within rail operations as the backgrounds of typical rail chief executives. He suggests that the limited abilities of these executives in marketing, technological innovation, and environmental scanning result in part from such a career track.[5]

If Wyckoff is correct, how were five of the railroads studied able to make such radical strategic changes? This study examined changes in the composition of the boards of directors for each holding company as compared to the composition of the board of directors for the corresponding railroad subsidiary. Dominance of holding-company boards and hence strategy by railroad operations-oriented executives was expected to be associated with little non-rail diversification. Where holding company boards include fewer common members with rail operations-oriented backgrounds, a more active strategy of non-rail diversification was expected. These expectations were confirmed by an examination of the degree of commonality of membership

Table I
Rail Revenue as a Percentage of Total Revenue by Holding Company
Average for 1973-76

Non-Diversified Firms	**Rail Revenue as a % of Total Revenue**
Missouri Pacific Corporation	76%
Rio Grande Industries	80%
Santa Fe Industries	78%
Southern Pacific Company	80%
Kansas City Southern Industries	72%
Average for Non-Diversified Holding Companies	77%[a]
Diversified Firms	**Rail Revenue as a % of Total Revenue**
Union Pacific Corporation	39%
IC Industries	32%
Northwest Industries	0%[a]
Katy Industries	40%
Western Pacific Industries	62%[b]
Average for Diversified Holding Companies	35%[c]

[a] Reduced its rail revenue contribution to zero through divestiture of its rail subsidiary, the Chicago & North Western Railway.

[b] Divested its railroad subsidiary after the completion of most work on this study.

[c] Significant at the .05 level.

Table II
Return on Rail Assets—Average of 1957 to 1960 Compared to "Riskless" Investment Alternative

	Diversified Firms	Non-Diversified Firms	"Riskless" Return On 30 Year U.S. Treasury Bond
Return on Total Assets	2.3%[a]	4.4%[a]	4.0%
Returns as a % of Riskless Return	58%	110%	

[a] Difference between means significant at 95% level

Table III
President's Orientation by Type of Strategy

	Diversifying		Non-Diversifying	
	Before Non-Rail Acquisition	After Non-Rail Acquisition	Before Non-Rail Acquisition	After Non-Rail Acquisition
Holding Company President's Years of Rail Operations Experience	33 years	0 years[a]	44 years	33 years[a]

[a] Significant at the .05 level

between holding company boards and railroad subsidiary boards at points in time prior to non-rail acquisitions. The firms with lower proportions of commonality in board membership became heavily diversified, while common board membership remained high for the five firms (classified as non-diversified in Table I) which made only a few small non-rail acquisitions.

In addition to the degree of board membership commonality, change in the orientation of holding company presidents was also investigated. A holding company president who served simultaneously as president of the railroad subsidiary could be expected to have experienced a long career in railroading. This career pattern was hypothesized to be associated with a corporate strategy of limited diversification into non-rail lines of business. Conversely, greater non-rail diversification was expected in instances where the holding company president lacked a railroading background.

Examinations of the backgrounds of holding company presidents confirmed these hypotheses, as indicated in Table III. The orientations of the presidents of holding companies which diversified were predominantly in law and investment banking—fields which provide appropriate dealmaking skills for firms committed to diversification by means of the acquisition of existing firms in non-rail lines of business.

PERFORMANCE AFTER NON-RAIL ACQUISITION

Data presented in Tables IV and V indicate that the average rate of return on total assets for the non-diversified holding companies taken as a whole was less than that earned by the holding companies which did not diversify heavily. * Indeed, the average rate of return for the diversified holding companies (Table IV) moved above that experienced by the non-diversified firms *only after* two of the holding companies removed their railroad subsidiaries from their financial statements. These asset removals were accomplished in different ways. Northwest Industries divested its subsidiary, the Chicago and North Western Railway, by selling it to the railway's employees. Katy Industries, unable to find a buyer or merger partner for its subsidiary Missouri-Kansas-Texas Railroad, wrote the railroad's equity down to a nominal value and ceased to consolidate railroad losses or earnings with its holding company statements. In addition to freeing themselves from the burden of

Table IV
Performance Before and After Diversification of Holding Companies[a]

Company	Rate of Return on Total Assets 1957-60	1961-64	1965-68	1969-72	1973-76
Union Pacific	2.5%	2.7%	4.0%	6.2%	7.7%
IC Industries	2.7%	3.0%	3.0%	4.7%	3.1%
Northwest Industries	1.2%	2.5%	2.4%	5.6%[b]	13.6%
Katy Industries	1.3%	−0.1%	−1.8%	8.1%[c]	5.6%
Western Pacific Industries	4.0%	3.3%	3.0%	2.5%	3.5%
Column Average	2.3%	2.3%	2.1%	5.4%	6.7%

Average of returns before diversification began = 2.3%[d]
Average of returns after diversification began = 5.1%[d]
Average of returns after rail subsidiary elimination = 9.1%.[d]

[a] Values before diversification began are to the left of the "stair-step" line. Values after diversification began are to the right of this line.

[b] Rail subsidiary sold six months before period ended.

[c] Rail subsidiary eliminated from holding company portfolio through equity write-down and nonconsolidation of rail financial statements with holding company financial statements in January 1971.

[d] Differences significant at 95 percent level.

Table V
Performance of Non-Diversified Holding Companies

Company	Rate of Return on Total Assets 1957-60	1961-64	1965-68	1969-72	1973-76
Missouri Pacific	6.0%	6.0%	5.8%	4.9%	3.9%
Rio Grande	5.8%	4.9%	5.0%	8.1%	7.1%
Santa Fe	3.5%	3.5%	3.4%	7.0%	6.5%
Southern Pacific	2.5%	3.7%	3.7%	4.8%	4.3%
Kansas City Southern	4.2%	3.8%	5.2%	5.5%	4.3%
Column Averages	4.4%	4.4%	4.6%	6.0%	5.2%

Average of returns before modest nonrail acquisitions = 4.0%.[a]
Average of returns after modest nonrail acquisitions = 5.4%.[a]

[a] Difference not significant (significant difference not expected.)

inadequate rail earnings by means of these transactions, both Northwest Industries and Katy Industries obtained substantial tax-loss benefits which will enhance their earnings over the period within which the tax losses can be offset against earnings from non-rail activities.[6]

SUGGESTIONS FOR FURTHER RESEARCH

Investigation of other aspects of the strategy, economic performance, and managerial thinking patterns of rail-based holding companies could be pursued to provide a more comprehensive perspective than it was possible to provide within the limits of this research. Comparisons between railroads included in holding company structures and railroads which have remained "pure" railroad companies could also be undertaken to ascertain whether and why companies in one category do or do not differ in managerial behavior and economic performance from those in the other.

FOOTNOTES

[1] Isabel H. Benham, "Rail-Based Conglomerates," *Financial Analysts Journal*, May-June 1972, p. 44.

[2] Richard P. Rumelt, *Strategy, Structure, and Economic Performance* (Boston, Mass.: Division of Research, Graduate School of Business Administration, Harvard University, 1974), p. 82.

[3] D. Daryl Wyckoff, *Railroad Management* (Lexington, Mass.: D.C. Heath, 1976), Cp. 5.

[4] Raymond E. Miles and Charles C. Snow, *Organizational*

Strategy, Structure and Process (New York: McGraw-Hill, 1978), Cp. 4.

[8] Wyckoff.

[9] *See, for example,* Benham, and *Northwest Industries Annual Report, 1971.* Writing down equity leaves the parent company with negative earnings for tax purposes. Recomputation of the parent's U.S. corporate income tax returns for the last four years can yield a sizeable corporate income tax refund. Losses not used to offset earnings in four prior years and the current year may be carried forward to shelter earnings for up to five future years. In the case of Northwest Industries the charge to earnings for equity written down was $400 million. (The rail subsidiary had $400 million equity and $400 million debt from total assets of $800 million.) With railroad earnings small or non-existent for years just prior to 1971, much of this $400 million offset to other earnings might expire unused if the holding company had not acquired other firms which generated positive earnings that could be sheltered. The earnings of acquired firms were worth more after tax computation when the firms were owned by the holding company than before these firms were acquired, because prior to acquisitions the earnings of these firms were taxed at a marginal rate of 48 percent. After acquisition by a holding company with large tax losses, the tax rate on the same earnings was zero.

Follow-up Statement

by Edward L. Sattler

to the Senate Committe on

the Judiciary Hearing on Rail Mergers

and the Burlington Northern Holding Company

June 1, 1982

1. Evidence of the relationship between the holding company structure and the railroad's performance:

Reese Taylor of the Interstate Commerce Commission (ICC) noted that a study by the commission in 1977 concluded that there is "no apparent causal relationship between railroad corporate structures and the provision of effective rail transportation service."[1] My research partially confirms that conclusion in that the holding company poses a minimal threat to the railroad if the railroad is relatively healthy financially and can compete well for capital within the holding company. However, my study found that the holding company structure combined with extensive diversification did tend to hurt railroads that were financially weak. Those railroads that had low rates of return were not able to effectively compete with other subsidiaries in the holding company for capital.

The ICC 1977 report, "Railroad Conglomerates and Other Corporate Structures," did not find any substantial benefits for the carrier in a holding company in terms of increasing the railroad's profitability, improving maintenance, or modernizing the railroad.[2] These potential benefits for the railroad are often claimed by holding company managements. My research generally confirms this finding of lack of benefits for the railroad. The ICC study found little evidence of the holding companies assisting the railroad in terms of the railroad's capital needs. The ICC report expresses the same warnings of the potential harm to the railroad that I have already detailed.[3] This potential harm includes excessive dividends paid by the railroad to the holding company, use of carrier credit and cash for non-carrier purposes, deferred maintenance, decreased capital outlays for the railroad, and dissipation of the carrier's assets.[4]

I should reemphasize that the holding company structure is not inherently harmful to the railroad unless the railroad's profits and operating characteristics begin to decline.

2. Richard Bressler's comments on the Burlington Northern Railroad and the Burlington Northern Holding Company:

Richard Bressler correctly states that the financial health and efficiency of the Burlington Northern Railroad have improved over the last several years. As long as the railroad remains relatively profitable, the holding company structure should not be a significant threat to the railroad subsidiary.

Mr. Bressler argues that historical rates of return have little to do with how much capital is invested today. He correctly notes that capital is invested based on expected future earnings and that many investments in the railroad earn a rate of return as high or higher than other investment opportunities.

I agree that capital is invested based on expected future earnings. In fact, capital is invested in specific projects based on the marginal or extra return to that specific project. It is certainly possible for a business with low rates of return historically to have high marginal rates of return anticipated for the future. For example, if demand for coal is expected to rise, then the purchase of coal-hauling cars and improvement of track to the coal fields could have high marginal rates of return in spite of a lower rate of return for the railroad overall.

People use historical rates of return in research and in discussions about competition for capital funds for two reasons. First, the historical data is available while the anticipated future returns are very subjective. More importantly, the future returns in a given industry are highly correlated with historical returns in most cases so that the historical returns provide an approximation of what might be expected. Also, specific projects being considered in business with higher historical and expected rates of returns are more likely to have a higher marginal rate of return and therefore attract capital.

Mr. Bressler also states that "all of the earnings from all of our businesses always flowed to the corporate level prior to the formation of the holding company." He then states that "budgetary and capital allocation decisions were made at the corporate level and that process continues."[5] The distinction that should be emphasized is that prior to the formation of the holding company, the ICC had regulatory control over the process, while now the holding company is beyond the control of the ICC. I believe this is one reason for the formation of the holding company and it is one of the reasons for concern about the long-term viability of the railroad.

3. Frequency of audits and variables considered:

The spokesmen for the General Accounting Office and the Interstate Commerce Commission seemed to agree that a closer monitoring of the railroad holding companies was appropriate. The remaining question is the frequency of the analysis. The ICC is apparently changing from a complete audit every two or three years to an audit of one subsidiary every year.

Recognizing the staff limitations, I would favor a selective auditing of specific railroad holding companies every year while others could be audited every three years. Those holding companies that have railroad subsidiaries that are financially weak are the most likely candidates to diversify heavily and eventually injure the railroad subsidiary. I would therefore suggest complete annual audits of those holding companies with the weakest railroads and a complete audit of the other railroads every three years.

Mr. Taylor listed some of the variables that the ICC would investigate on page 6 of his follow-up material. I am confident the ICC is aware of the potential problems of railroad holding companies and, using their 1977 study as a guide, can choose the appropriate variables to monitor the performance of the railroad and the holding company.

FOOTNOTES

[1] Reese H. Taylor, Jr., *Statement of Reese H. Taylor, Jr., Chairman, Interstate Commerce Commission Before the Senate Committee on the Judiciary on Rail Merger Policy*, p. 12.

[2] Reese H. Taylor, Jr., p. 11.

[3] Edward L. Sattler, *Statement by Edward L. Sattler to the Senate Committee in the Judiciary Hearing in Rail Mergers and the Burlington Northern Holding Company*, p. 5.

[4] Reese H. Taylor, Jr., p. 12.

[5] Richard M. Bressler, *Statement of Richard M. Bressler, Chairman and Chief Executive Officer, Burlington Northern, Inc., Before the Agency Administration Subcommittee of the Senate Judiciary Committee*, p. 7.

ASSOCIATION OF
AMERICAN RAILROADS
AMERICAN RAILROADS BUILDING · WASHINGTON, D. C. 20036

WILLIAM H. DEMPSEY
President and Chief Executive Officer

March 26, 1982

The Honorable Max Baucus
U. S. Senate
1107 Dirkson Senate Office Building
Washington, D.C. 20510

Dear Senator Baucus:

I refer to your letter of March 18 concerning the hearing on rail mergers to be held today by the Committee on the Judiciary. In connection with that hearing you asked that I submit a statement covering those issues. The issues and my responses are as follows:

1. Issue. Please sketch your position on ICC rail merger policies and procedures. If there are opportunities for streamlining or improving these policies and procedures, please identify them in detail.

Answer. The ICC's rail merger policies and procedures have evolved over the last several years in response to the changes in the transportation industry's competitive and regulatory environment wrought by the 4-R Act and the Staggers Act. The AAR believes that the Commission has formulated rail merger policies and procedures that generally are responsive to these legislative initiatives.

For example, both the 4-R Act and the Staggers Act established strict statutory timetables for the Commission to follow in considering proposed rail mergers. The Commission adopted these timetables and decided the recent Burlington Northern/Frisco, CSX, and Norfolk and Western/Southern merger cases substantially in advance of the statutory deadline. The Cotton Belt's acquisition of the former Rock Island's Tucumcari line was also handled expeditiously. A decision in the Union Pacific/Missouri Pacific/Western Pacific merger proposal is likewise expected to be rendered well within the allowable time frame.

The Commission also has actively considered its railroad consolidation procedures and policies. On November 20, 1979, it instituted a general rulemaking proceeding, Ex Parte No. 282 (Sub-No. 3), to revise its rail consolidation regulations governing the submission of evidence. The AAR participated in this rulemaking proceeding and on February 19, 1982, the Commission established final rules for rail merger applications which appear to be satisfactory.

Similarly, in a related rulemaking proceeding, Ex Parte No. 282 (Sub-No. 6), the Commission considered its rail consolidation policies and on February 2, 1981, issued a General Policy Statement which reflects previously articulated Commission policy as well as changes to that policy mandated by the Staggers Act. The Commission has continued to review its rail merger policies and on March 9, 1982, issued a decision, Ex Parte 282 (Sub-No. 5), rejecting the imposition of standard traffic protective conditions in rail consolidation proceedings.

The AAR believes that the Commission has been diligent in establishing and following railroad merger policies and procedures that are consistent with the provisions of the Interstate Commerce Act as amended by the 4-R Act and the Staggers Act. The Association also believes that the ICC's recent review of its policies and procedures demonstrates the Commission's desire to streamline and improve its rail merger procedures. The Association has no additional suggestions at this time concerning opportunities for streamlining or improving existing policies and procedures.

2. Issue. Please outline your position on ICC review of rail holding companies.

Answer. The AAR is opposed to unnecessary regulation and believes that ICC regulation of rail holding companies is not consistent with deregulation of the underlying carrier or carriers. The Commission has traditionally applied the "primary interest in transportation" and "principal source of income" tests to determine whether regulation of non-carrier holding companies is justified, and we believe the Commission should continue to examine the specific facts and circumstances of each situation to determine whether subjecting a non-carrier holding company to the same accounting, reporting and securities regulations imposed on its subsidiary carrier will serve any valid purpose.

3. Issue. Please identify specifically the ways in which ICC review of rail securities issuance has impeded or does impede the development of non-rail properties owned by railroads or railroads' ability to invest in non-rail activities.

Answer. Present ICC regulation may impede the development of non-rail assets under railroad ownership and the maximizing of profits -- contrary to the interest of the railroad industy itself, the railroads' shareholders, and the public. Under 49 U.S.C. §11301, the Commission may approve the issuance of securities by a carrier if the Commission finds that the issuance: (1) is for a lawful object within the corporate purposes of the carrier and reasonably appropriate for that purpose; (2) is compatible with the public interest; (3) is appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier; and (4) will not impair the financial ability of the carrier to provide the service. Traditionally, the ICC and the rail industry have viewed this section of the Interstate Commerce Act, requiring authorization of railroad security issuances, as severely limiting the issuance of securities by rail carriers for the purpose of financing projects unrelated to transportation activities. This contruction has prevented rail carriers from drawing upon external financing as a source of long-term funds needed to develop their non-rail properties and has been a factor influencing the formation and use of parent holding companies or non-carrier subsidiaries for these purposes. While new legislation could eliminate doubts as to the Commission's powers to authorize issuance of carrier securities for purely non-carrier or indirectly-related carrier purposes, the present law can be so construed by the ICC without amendment.

I appreciate the opportunity to present the views of the AAR on these issues.

Sincerely,

William H. Dempsey

William H. Dempsey

United States Senate

MAX BAUCUS
Montana

Washington, D.C. 20510
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Montana Toll Free No.
(1) 800-332-6106

April 8, 1982

Mr. Richard Bressler
Chairman of the Board
Burlington Northern
1111-3rd Street
Seattle, WA 98101

Dear Dick:

I appreciate your note on BN's responses to our hearing questions. Your oral testimony at that hearing was very helpful in many respects, and I appreciate it. Obviously, if we'd had more time, we could have explored a number of matters in considerably greater detail. But, the hearing provided a good beginning.

After reviewing the transcript, I would like to pursue some of the issues raised at the hearing and hope you can help us complete the record by responding to the following questions. As you'll recall, the record will be kept open for 30 days to permit additional statements, any rebuttals you'd care to make on the testimony of other witnesses, and your responses to these questions. Should that prove to be insufficient time, please let me know and we'll try to make alternative arrangements. Of course, some of the questions overlap with those previously covered in the hearing, but I ask them in an effort to obtain a more precise answer.

1. I remain curious about the timing of the holding company announcement. It was announced some two months after the BN/Frisco merger was approved by the Interstate Commerce Commission. It appears, then, that it must have been under active consideration by BN during the pendency of that merger. Nonetheless, no mention of the holding company was made during the merger proceedings. Would you explain why that was the case? To be direct about this, if BN decided that an announcement prior to ICC approval of the merger might have delayed or complicated the formation of the holding company -- either through the exercise of ICC jurisdiction or otherwise -- please simply indicate that fact and sketch the difficulties that might have arisen.

2. Was the holding company securities prospectus accurate when it asserted "ICC...limitations prohibit railroad from issuing securities for the acquisition or development of non-transportation assets." Or, is the sole concern as you expressed it in your testimony -- i.e., that a subsidiary like Plum Creek would be placed at a competitive disadvantage if required to undergo ICC scrutiny of its securities issuances? In short, did ICC exercise of its securities review authority actually "prohibit" the issuance of securities for the development of non-transportation assets or did it merely raise competitive apprehension on the part of BN?

3. You indicated that you would, for the record, attempt to catalog the dollar benefits that accrued as a result of the 1970 BN merger and the recent BN/Frisco merger. Please be certain to indicate the sources of the benefits and compare them to the benefits and source of benefits projected before the merger.

4. You indicated further that you would specify and attempt to estimate the value of property transferred from the merged railroad to the holding company or its non-rail affiliates. These apparently include a number of Frisco properties. In addition, please provide details of the compensation arrangements -- money or other considerations that will be provided to the railroad in exchange for those properties transferred. Please further indicate if any other asset transfers are being contemplated.

5. Mr. Grayson indicated in his testimony that BN had a rail cost reduction plan. I would appreciate receiving a copy of the plan for the record.

Committees
Environment and Public Works
Finance
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Small Business

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657-6790
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449-5480
Missoula
728-2043

6. Is BN considering the sale of any portion of its transportation business -- beyond the air freight forwarding concern -- including any portion of the railroad?

7. Mr. Grayson indicated that there were areas in which BN feels over-regulated, notwithstanding passage of the Staggers Act. Please specify those areas and any proposed reforms.

8. You indicated that BN would provide a 10-year compilation of natural resource contributions to the railroad. Please include tabulations of income available for fixed charges by source (rail and non-rail), and the level of fixed charges. In addition, please supply a current set of income before tax figures for each line of business comparable to the figure provided in annual reports issued prior to 1980.

9. Are there any other specific coal slurry pipeline or coal/methanol pipeline projects that BN is considering -- on its own or as joint ventures -- beyond the Cascade summit project? Please indicate the dimensions of the Cascade and other projects -- including their anticipated capacity, water demands, estimated costs, and associated facility requirements.

10. Please sketch BN's practice and procedure for notifying employees concerning actual or potential layoffs or furloughs. How much advance notice is typically given? Is this a goal or a consistent practice?

11. Is it the case that BN currently has no labor force reduction goal or labor level targets?

12. You indicated that BN has some $300 million in cash earning a return in short-term securities. Do you expect an enhanced cash position over the next 12 to 18 months? If so, at what level? Has a line of credit been assembled -- or do you plan to assemble a line of credit -- in conjunction with the accumulation of cash? If so, at what level? What are BN's current plans for the cash accumulation and lines of credit?

13. Is BN contemplating a stock swap for the Northern Pacific land grant bonds or some form of asset sale that would provide proceeds to the bond trustee?

Dick, again, I appreciate your participation in the hearing. I look forward to your responses and to working with you in the future. Obviously, as the answers to any of the questions above, and those pursued in the hearing itself, change, I would appreciate hearing in advance about them.

With best personal regards, I am

Sincerely,

Max

BURLINGTON NORTHERN INC.

RICHARD M. BRESSLER
Chairman & Chief Executive Officer

12 April 1982

The Honorable Max Baucus
1107 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Max:

This will acknowledge your letter to me of April 8 asking for response to some additional questions. We will try to get back promptly to you on these. I will try to respond to question #9 now, inasmuch as my response to your question at the hearing on slurry lines seemed to draw the most interest.

Burlington Northern is not now nor considering to expend any effort, either in time or money, in pursuing any coal slurry line venture. My response to the question was intended to indicate our attitude about slurry lines, which is so often portrayed as 100 per cent against them under all circumstances. I had indicated to you that, other things being equal, as a company and as a nation we should be interested in the lowest cost medium of transportation, whether it be slurry lines, trucks, railroads, barges, etc. The "other things being equal" part of my response considered the following:

(1) If there were no overriding environmental considerations: In my view and in apparently many others', there is a serious question whether the water resources in the Powder River Basin are adequate to accomodate coal slurry lines in addition to the other demands on this resource.

(2) The slurry lines should not be awarded any special privileges denied to competing forms of transportation, such as Federal eminent domain and operation as a private as opposed to a common carrier. I think I indicated that our company as well as the industry generally was not denying slurry lines crossing over the railroad's right of way.

(3) There was a possible role for slurry lines where investments in adequate transportation capacity had not already been made, such as some of our rail lines leading from the Powder River Basin.

If you would like to discuss this with me further I would be happy to talk about it. I am sure you saw it, but also attached is an item from the Livingston Enterprise which characterizes the kind of reporting that followed that brief exchange at your hearing.

Very truly yours,

R. M. Bressler

cc: Livingston Enterprise Editor

4—LIVINGSTON ENTERPRISE, Friday, April 2, 1982

opinions

Turncoat turnabout

Montana's anti-slurry efforts took an odd turn this week, when one of coal slurry's leading opponents turned into a proponent.

Ever since somebody suggested Montana's coal could be transported easier by crushing it, combining it with water and pushing it through a pipeline, the Burlington Northern Railroad has been opposed to the idea. The BN hauls most of the coal that comes from Montana's coalfields, and obviously woould like to hang onto the business. A lot of the BN's employees in Montana depend on coal-hauling revenues for their jobs ... and so on. BN has carried the flag when it came to fighting against coal slurry.

Whenever anyone else came up with an argument against the slurry idea; the BN was there to help. The main point against slurry, in addition to its impact on the railroads, is its potential impact on our water supplies – a threat the BN was the first to agree is worthy of our greatest consideration.

So, it comes as something of a surprise that a BN official announced this week the railroad might very well be changing its tune about slurry. The BN -- which owns large eastern Montana coal deposits in addition to its other assets – apparently would like to get some of it moving to out-of-state markets, and is beginning to see cost savings in sending it in a slurry pipeline.

Even the railroad, in other words, can't afford to ship coal on the railroad.

That's pretty alarming news to those of us left in the anti-slurry camp. In the first place, there was great comfort knowing the BN was leading the lobbying effort in Washington. But even more importantly, it means we've lost a strong ally in our fight to preserve our vital water resources.

In a way, the whole turnabout by the BN has a little turncoat flavor to it ... and leaves some of us with the feeling the railroad was ready to lodge lofty arguments against slurry so long as it seemed profitable, but now that the dollars appear to flow the other direction the railroad changes its philosophy accordingly. That's expectable, we suppose, with large corporations and particularly railroads, but somehow we had hoped it wouldn't happen in the slurry battle.

BURLINGTON NORTHERN INC.

RICHARD M. BRESSLER
Chairman & Chief Executive Officer

May 25, 1982

The Honorable Max Baucus
1107 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Max:

I have set out below my additional responses to your letter of April 8. I previously replied on April 12 to question #9 relating to pipeline projects.

1. Timing of Holding Company Announcement - I have very little to add to my oral testimony on this matter. Decisions and an announcement about a holding company structure followed consummation of the BN-Frisco merger because at the time of merger we were concentrating our efforts on preparations for and implementation of the merger.

The Commission decided the merger case on March 25, 1980, nearly eight months before the time of merger. No mention of a holding company was made during the ICC proceedings because no decision had been made to form a holding company.

2. Accuracy of Securities Prospectus - The passage from the April 14, 1981 Proxy Statement to which you refer is part of a paragraph which reads in relevant part as follows:

> "The Interstate Commerce Act requires the Railroad to obtain prior approval of the Interstate Commerce Commission (ICC) for issuance of its securities. The authority of the ICC to grant its approval is restricted to security issuances which it finds to be reasonably necessary for, or consistent with, the proper performance by the Railroad of service to the public as a common carrier. The practical effect of

> this restriction, as construed by the ICC, is to prohibit the Railroad from issuing securities for the acquisition or development of non-transportation assets, thereby greatly limiting the Railroad's ability to develop such assets."

Our attorneys have again reviewed this statement and we stand by it. The Commission has in the past ruled that, under Section 11301 of the Interstate Commerce Act, issuance by a carrier of securities generally should be authorized only in those instances where it would be of benefit to the carrier's transportation services. Only under limited circumstances has the Commission occasionally approved issuance of securities for a non-carrier purpose. You will note that the Proxy Statement refers to the practical effect on BN of the statutory restrictions.

3. Benefits of Mergers

A. Northern Lines Merger - We have again reviewed our files concerning dollar benefits. We simply cannot quantify currently the dollar benefits of our 1970 merger. There were substantial delays between the date of the original application filed in 1961, the submission of new savings information in 1967, and the actual merger in March 1970. In the twelve years since merger we have experienced the enormous development of our Western coal traffic, other rail mergers and reorganizations, the elimination of most passenger service operation through the transfer of intercity passenger service to Amtrak, rampant inflation, and a wide variety of technological and managerial changes.

We have listed in Appendix A benefits which the applicants and/or the Commission indicated the merger would produce. Some of these benefits can be identified as merger-related as a matter of reasonable business judgment or experience. Others, such as the expected increase in revenues and the reduction in the number of jobs, would require a prodigious analysis in order to eliminate the impact of other factors such as those mentioned above, if indeed they could be eliminated. However, in our judgment all of the benefits listed in Appendix A occurred in whole or in part only because of the Northern Lines merger.

As indicated by my earlier testimony, after 1973 BN discontinued the complex and burdensome procedures then in effect for identification of merger savings.* At that time over $23 million of net annual recurring gains had been quantified, excluding traffic gains. These gains are shown in Appendix B.

B. BN-Frisco Merger - We thought at the hearing we would be able to provide you with dollar benefits achieved so far as a result of this merger, which occurred on November 21, 1980, about 18 months ago, even in the absence of ongoing studies. (Given the prior abortive experience in trying to measure Northern Lines merger savings, no systematic program for attempting to measure savings from the BN-Frisco merger was ever undertaken.)

However, the period since late November 1980 has been marked by a sharp downturn in the nation's economy and by aggressive managerial initiatives at Burlington Northern Railroad Company. Both of these major factors yielded significant curtailment of labor and other expenses, particularly in the face of substantial declines in traffic. Again, these factors render quantification of dollar benefits resulting from the BN-Frisco merger virtually impossible with any degree of accuracy, and any theoretical study of such savings would likewise be of questionable value.

The applicants' total projected cumulative pre-tax benefits (in the form of annual cost savings) through the first three years following merger were as follows:

(In Millions of Dollars)

Year One	Year Two	Year Three
$2.27	$25.26	$33.05

We believe that some of these savings have been achieved, but we cannot quantify savings due solely to merger either by source or en toto.

---

* The work was discontinued three years after merger, rather than after the "year or two" referred to in the appendix to my March 26 prepared statement.

The BN-Frisco merger was an end-to-end merger, and the applicants based their case more on improved service to customers than on dollar savings. The following anticipated key service benefits were shown as part of the record in the ICC proceedings:

1. Single-line service for traffic originating and terminating in the BN-Frisco 25-state service area;
2. More direct routing of joint traffic;
3. Elimination of the present BN-Frisco interchanges and the associated delays in transit;
4. Shorter and more reliable transit times for many shipments;
5. Enhanced ability to control and trace shipments;
6. Increased opportunities for innovative service and rate proposals;
7. Improved freight car supply;
8. Increased utilization of existing train and line capacity, with resulting greater efficiencies;
9. Unification of facilities and activities related to the maintenance of roadway and freight equipment;
10. Strengthened finances for the combined company over the financial positions of the separate applicants;
11. Strengthened competition throughout the area to be served, because of the new company's efficient single-line service, equipment control and ratemaking capabilities; and
12. Participation in and support for long-term economic expansion in the Southeast and Southwest.

In our reasoned business judgment BN has realized all these benefits as a result of the BN-Frisco merger.

4. Asset Transfers - The only assets of the former Frisco which Burlington Northern Railroad Company transferred to the holding company were 1,078,941 shares of common stock in New Mexico and Arizona Land Company. These shares were transferred as a dividend at a value of $4,998,578, representing the cost assigned by the parties to the stock in accounting for the BN-Frisco merger.

I have previously referred to other asset transfers on pages 1-3 of the appendix to my March 26 prepared statement. The values on our books of the pipeline stocks which the Railroad Company transferred to Milestone Petroleum Inc., our oil and gas subsidiary, are as follows:

Butte Pipe Line Company	$ 180,000
Portal Pipe Line Company	7,548,000

These figures represent the cost of the Railroad's investment in Butte Pipe Line and the net carrying value in Portal Pipe Line (investment at cost plus equity in retained earnings). The Railroad transferred these stock interests as capital contributions to Milestone, and as part of our program to redeploy assets to the appropriate lines of business.

5. Rail Cost Reduction Plan - The Railroad's cost reduction plan is simply an ongoing program which bears on innumerable management decisions. There is no documented rail cost reduction plan. As we testified at the March 26 hearing, we are continually searching out ways to make the Railroad more efficient. Our investment in modern track maintenance machines is just one example of that unremitting search.

6. Sale of Transportation Businesses - Burlington Northern is not now considering the sale of any portion of its transportation businesses other than disposition by our trucking subsidiary of some unneeded highway rights in the Southwest. No portion of the Railroad is under consideration for disposition other than sales resulting from authorized abandonments.

7. Concerns About Regulation - We intended to state two elemental facts at the March 26 hearing. First, the Staggers Act did not completely deregulate the railroads. The ICC still regulates many of our important rate matters. It regulates all line abandonments, rail mergers and consolidations, some financial transactions and many other aspects of the Railroad's business. The Act placed some time limits on actions required by the ICC that have been helpful.

Second, some continued Government regulation is detrimental. For example, railroads lack the freedom to eliminate their participation in routes when such participation is not in the public interest. In addition, the ICC persists in regulating rates which are below the agency's jurisdictional threshold (we are seeking judicial relief). In determining rail costs under the Staggers Act the Commission has failed to establish and employ consistent standards for developing revenue/cost relationships for its regulatory purposes. The Commission has been overly restrictive in authorizing abandonment of excess and marginal facilities. It retains unnecessarily cumbersome filing requirements for approval of rail securities.

8. Financial Data - The information you requested is set out in Appendices C, D, E and F. We have included in Appendix F pre-tax net income by lines of business for 1981 even though, consistent with our practice before 1976, we did not disclose this information for a portion of 1981. We regard operating income as a better measure of performance by our lines of business than the total of pre-tax net, which includes interest and other non-operating income.

In your letter you have referred to "resource contributions to the railroad." Our showing of resources operating income in Appendix C does not equate to "contributions to the railroad." BN has no record reflecting the application of any particular income flow for the years shown.

9. Pipeline Projects - I responded to this question in my letter of April 12.

10. Notification of Employees Concerning Layoffs - The Railroad Company's procedure for notifying employees concerning actual or potential layoffs or furloughs is governed entirely by various collective bargaining agreements. The procedures differ from craft to craft, and the notice period depends in part on the reasons for the reduction in force. Because of the large number of union agreements, with varying terms, we cannot summarize notification procedures.

11. Labor Force Reduction Goals - The answer to your question is Yes. We have no specific numerical reduction goals or labor levels.

12. Cash Position - As of April 30, 1982, the company had approximately $300 million in cash, and in addition we currently have revolving credit agreements and lines of credit totalling $875 million. Beyond that, Max, I cannot comment. We have consistently adhered to a policy of avoiding public projections of revenues, income or cash flow.

13. Stock Swap - BN is not contemplating a stock swap for bonds secured by mortgages on the Northern Pacific land grant lands. We are not contemplating any form of asset sale, which would provide proceeds to the trustees of the mortgages, other than the sale of land grant parcels in the ordinary course of business such as have occurred in past years.

I trust the foregoing information will be of help to you.

Very truly yours,

Dick

R. M. Bressler

Enclosures

APPENDIX A, Page 1

BURLINGTON NORTHERN INC.

Indicated Benefits of Northern Lines Merger

1. Better transportation service at lower expense than would be realized under separate operation of the properties;
2. Combination of the best features of the applicants, so as to eliminate circuitous routes and severe grades;
3. Consolidation and modernization of terminal and yard facilities at certain common points to eliminate interchanges and delays resulting from such interchanges;
4. Better car supply by numbers and types;
5. More efficient handling and distribution of empty cars;
6. Strengthening of motor carrier subsidiary operations;
7. Reduction of long-term debt and fixed charges by redemption of Northern Pacific's Refunding and Improvement Bonds;
8. Increase in traffic revenues by $43,000,000 by end of fourth year of operation;
9. Abandonment of line segments made possible because of the utilization of the more efficient parallel lines (between Breckenridge and Moorhead, Mn.; at Helena, Mo., and Spokane, Wa., and between Spokane and Marshall, Wa., for example);
10. Consolidation of train operations;
11. Reduction in the number of locomotive units;
12. Reduction in expense by maintaining general repair facilities and by consolidation of certain repair facilities;
13. Reduction of stocks and materials;
14. Elimination of intercorporate income taxes;
15. Consolidation of executive traffic, engineering accounting, and loss and damage claim departments;

16. Increased utilization of locomotives and cabooses;

17. Better car tracing systems;

18. More extensive and more efficient communication systems;

19. Expanded use of centralized traffic control;

20. Elimination of combination rates on certain commodities;

21. Extension of transit and stop-off privileges;

22. Reduced damage to cargo because of fewer interchanges;

23. Reduction in total number of officers;

24. Elimination of 8,072 jobs;

25. Lower per diem costs because of faster schedules;

26. Less cars needed because of car-days saved from faster service;

27. Reduction in clerical time (because tracing claims, car ordering, diversion and car accounting would be simpler);

28. Enhancement of intra- and intermodal competition;

29. Opening of new markets and sources of supply to industries because of Milwaukee and C&NW conditions;

30. Increased capacity to handle national defense needs.

APPENDIX B

BURLINGTON NORTHERN INC.

REPORTED MERGER GAINS AND LOSSES

ITEM (a)	CHANGES IN NET INCOME 1973 TO DATE(1) (b)	ANNUAL RECURRING GAINS AND LOSSES WYER REPORT BASIS(2) (c)
Net Abolishment-146 Positions in 1973	$ 998,600G	$10,596,200G
Separation Allowances-154 Employees	1,509,900L	-
Employee Transfer Cost	223,800L	-
Wage Adjustments	-	970,200L
Wage Guarantee	4,131,900L	-
Unfilled Jobs Prior to M Day	-	602,200G
Joint Facilities-Net	1,012,700G	1,102,400G
Washington Excise Tax	-	141,000G
Income Tax-CB&Q Dividends	-	350,000G
Pension	-	187,000G
Property Rentals-Net	-	121,000L
Utilities-Net	64,200L	223,100G
Data Processing Equipment	-	2,453,700G
Additional Interest-NP Bond Retirement	-	797,300L
Miscellaneous Savings	1,481,900G	2,492,100G
Miscellaneous Expenses	1,300L	120,200L
New Construction:		
Operating Expense	958,700L	-
Capital Accounts $51,177,300 @ 8%	582,700L	4,094,200L
Building Remodeling:		
Operating Expense	12,400L	-
Capital Accounts $ 2,039,600 @ 8%	800L	163,200L
Local Freight Trains	-	4,455,100G
Yard Switching	2,482,500G	2,606,200G
Through Freights-Shorter Routes	4,696,800G	4,696,800G
Switching Revenues	-	200,000L
Ore Dock Maintenance	-	122,900G
Car Hire Reclaims Paid C&S-FW&D	955,200L	-
		$30,028,700G
		6,466,100L
	Net Annual Gain	$23,562,600

(1) Includes only those changes reported during 1973. Does not include the effect of 1970-1972 reported changes on 1973 accounts.

(2) Savings and expenses generated during 1970-1972 stated in 1970-1972 dollars. No adjustments made for changes in price levels.

APPENDIX C

BURLINGTON NORTHERN INC.

RESOURCES* OPERATING INCOME

Years 1972-1981

(In Thousands of Dollars)

Year	Amount
1972	$ 28,232
1973	23,088
1974	52,226
1975	45,820
1976	60,002
1977	64,291
1978	79,389
1979	95,713
1980	106,757
1981**	108,318

---

* Includes operating income from oil and gas, coal and minerals, forest management and land.

** Includes operating income for Burlington Northern Inc. and its successor, Burlington Northern Railroad Company.

May 12, 1982
ke2

APPENDIX D, Page 1

BURLINGTON NORTHERN INC.

INCOME AVAILABLE FOR FIXED CHARGES

BY LINE OF BUSINESS

Years 1974 - 1981*

(In Thousands of Dollars)

Line of Business	1974	1975	1976	1977	1978	1979	1980	1981
Railroad	$ 94,562	$ 71,044	$ 75,693	$ 56,133	$ 80,346	$120,868	$270,413	$411,862
Trucking	(475)	280	1,388	2,780	2,573	1,166	(2,186)	901
Air Freight	952	1,531	3,545	4,650	8,937	19,519	23,000	28,358
Forest Products Manufacturing	4,865	3,542	9,377	13,704	18,189	17,467	14,843	1,959
Resources **	53,585	49,732	61,342	66,162	81,821	98,033	110,366	118,277
Other and Eliminations	10,427	5,424	1,494	5,595	5,163	1,435	(2,113)	(1,940)
Totals	$163,916	$131,553	$152,839	$149,024	$197,029	$258,488	$414,323	$559,417

---

* Details for years 1972 and 1973 are not available.

** Includes income from oil and gas, coal and minerals, forest management and land. See Page 2 of this Appendix.

May 12, 1982
ke3

APPENDIX D, Page 2

BURLINGTON NORTHERN INC.

INCOME AVAILABLE FOR FIXED CHARGES

RESOURCE LINES OF BUSINESS

Years 1974 - 1981*

(In Thousands of Dollars)

Resource Line of Business	1974	1975	1976	1977	1978	1979	1980	1981
Oil and Gas	$ 14,619	$ 11,835	$ 14,810	$ 12,710	$ 18,620	$ 22,850	$ 41,570	$ 54,611
Coal and Minerals	3,393	7,105	5,900	5,790	4,971	7,830	10,560	6,842
Forest Management	20,118	11,615	20,446	22,081	31,019	41,432	32,965	29,397
Land	15,455	19,177	20,186	25,581	27,211	25,921	25,271	27,427
Total	$ 53,585	$ 49,732	$ 61,342	$ 66,162	$ 81,821	$ 98,033	$110,366	$118,277

---

* Details for years 1972 and 1973 are not available.

May 12, 1982
ke4

APPENDIX E

BURLINGTON NORTHERN INC.

CONSOLIDATED FIXED CHARGES

Years 1976-1981

(In Thousands of Dollars)

Year	Amount
1972	$ 48,901
1973	53,633
1974	58,314
1975	64,387
1976	65,267
1977	68,103
1978	73,577
1979	83,117
1980	106,680
1981	140,442

May 12, 1982
ke5

APPENDIX F, Page 1

BURLINGTON NORTHERN INC.

INCOME BEFORE INCOME TAXES

BY LINE OF BUSINESS

Years 1976 - 1981*

(In Thousands of Dollars)

Line of Business	1976	1977	1978	1979	1980	1981
Railroad	$ 12,023	$(10,604)	$ 8,817	$ 39,417	$165,280	$277,921
Trucking	1,237	2,610	1,792	10	(3,571)	(381)
Air Freight	3,545	4,626	8,849	19,425	22,910	28,270
Forest Products Manufacturing	8,728	13,070	17,593	16,589	13,817	1,011
Resources **	60,725	65,669	81,136	97,112	109,495	116,961
Other and Eliminations	1,314(1)	5,550(1)	5,265(1)	2,818(1)	(288)(1)	(4,807)
Totals	$ 87,572	$ 80,921	$123,452	$175,371	$307,643	$418,975

---

* Data for years prior to 1976 either not available or not released to public.

** Includes income from oil and gas, coal and minerals, forest management and land. See Page 2 of this Appendix.

(1) Corporate income and expenses, primarily interest and dividend income, and certain amounts attributable to non-operating corporate activities are not allocated to the individual activities except where specific identification is possible. Other Income - Net is allocated on the basis of specific identification for the related activity.

May 12, 1982
ke6

APPENDIX F, Page 2

BURLINGTON NORTHERN INC.

INCOME BEFORE INCOME TAXES

RESOURCE LINES OF BUSINESS

Years 1976 - 1981*

(In Thousands of Dollars)

Resource Line of Business	1976	1977	1978	1979	1980	1981
Oil and Gas	$ 14,637	$ 12,680	$ 18,362	$ 22,373	$ 41,343	$ 54,468
Coal and Minerals	5,838	5,727	4,912	7,780	10,519	6,808
Forest Management	20,435	22,065	30,996	41,405	32,905	29,307
Land	19,815	25,197	26,866	25,554	24,728	26,378
Total	$ 60,725	$ 65,669	$ 81,136	$ 97,112	$109,495	$116,961

May 12, 1982
ke7

---

* Details for years prior to 1976 either not available or not released to public.

LAW OFFICE
DANIEL HOYT SMITH
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TELEPHONE 682-1948
AREA CODE 206

March 15, 1982

Hon. Max Baucus
United States Senate
Washington, D.C. 20510

Re: Burlington Northern Holding Company
Senate Committee on Judiciary Hearings of March 26, 1982

Dear Senator Baucus:

Thank you for the invitation to appear and testify at this important proceeding. I am submitting for inclusion in the hearing record the brief we filed in the Federal District Court in Seattle, Washington, in support of our challenge to the Burlington Northern Holding Company strategy, on behalf of the Citizens Committee to Save the Land Grant Railroads, and a number of labor organizations. Since our brief is rather lengthy, I will summarize our position, report to you on the current status of the litigation, and our beliefs as to what the response of Congress ought to be.

The basic theory behind our position is found in two longstanding court decisions. The first was by the Supreme Court of the State of Washington:

> [L]et us keep in mind as we proceed that appellant is not a private business concern, but is a public service transportation corporation;...that appellant cannot abandon its duty to serve the public, nor can it dispose of its property, real or personal, in such a manner as to result in discontinuance of such service; that appellant and its successors in ownership of such property are bound to maintain such service, and incidentally to maintain an organized entity necessarily consisting of equipment and operating property, both real and personal, as a unit organization such as will make the rendering of such service possible.

Northern Pacific v. State, 84 Wash. 510 at 523 (1915). A second precedent is the decision of the United States Supreme Court, holding that:

> Railroads are for many purposes public highways.... Corporations, it is true, formed for their construction are private corporations, but whilst their directors are required to look to the interests of their stockholders, they must do so in subordination to and in connection with the public interests, which they are equally bound to respect and subserve. All arrangments, therefore, by which directors or stockholders or other persons may acquire gain, by inducing those corporations to disregard their duties to the public are illegal....

Woodstock Iron Company v. Extension Company, 129 U.S. 643, 656 (1889).

Our lawsuit is based on the propositon that Burlington Northern's Holding Company strategy should be declared illegal because it constitutes a clear and present danger to the continued financial viability of essential rail services. As the ICC has reported to Congress:

> Were the railroads receiving these properties, or their railroad successors in interest, to be deprived of the fruits of these land grants, at a time, whether now or in the future, when they are needed to support rail services essential to the public interest, the intention of the Congress in making these grants would be subverted and today's citizens would lose the benefit of the contract made by their forebears with the Land Grant Railroads.--"Railroad Conglomerates and Other Corporate Structures," Feb. 5, 1977, p.74.

Our brief points out over a dozen ways in which the Holding Company strategy threatens the future of the railroad.

The response of the lawyers for the Holding Company to our claims was that they have no obligations to the public, and that even if everything we say is true, we have no right to complain about it. The Holding Company's position is that Northern Pacific did everything it was obligated to do to earn its over 40,000,000 acres of public land when the railroad construction was completed. They feel that if they can earn more profits for their stockholders (largely banks and other large corporations) by non-transportation activities, it is their right to divert the proceeds from the land grants to such activities regardless of the adverse impact on the railroad.

The decision of the Federal District Court Judge was that, even if the Holding Company strategy is violating the intent of Congress, private parties like the plaintiffs in our case shall not be allowed to challenge it in federal court, and that further Congressional action would be required to provide a remedy for such violations as may be occurring.

This presents an urgent necessity for Congressional investigation and action. ICC oversight should not depend on the technical question of whether a few independent switchyards and terminals are actually controlled by the BN system. The disintegration of our national rail transportation system may well become irreversible if rate structures and investment decisions are left in the unreviewable discretion of directors tempted by higher returns in energy or entertainment speculation.

We applaud your initiative in reopening the congressional scrutiny of these thorny problems. Only on the basis of full disclosure by the holding companies, and independent economic analysis by representatives of the public interest, can the Congress structure intelligent and appropriate legislative action.

Sincerely yours,

Daniel Hoyt Smith
Attorney for CSLGR

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JEROME T. ANDERSON (1924-1972)
PHILLIP B. LUSH (1910-1979)

April 7, 1982

Mr. Quentin Crommelin, Jr.
Staff Director
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Re: Railroad Mergers, Hearing
March 26, 1982
Witness: Patrick J. Foley
Proposal: Supplemental Statement

Dear Mr. Crommelin:

In your recent letter, you indicated that there may be a possibility of supplementing what I have already testified to and submitted by written statement in connection with my appearance as a witness on railroad mergers at your hearing on March 26, 1982.

One point I would like to observe is the following excerpt from the appendix to the statement of Richard M. Bressler, Chairman and Chief Executive Officer to Burlington Northern Inc. On page 11 of that appendix, he makes the following statement:

> At the time of the Northern Lines case scheduled running time for Great Northern and Northern Pacific's fastest trains from Seattle to Chicago (via the Burlington from Minneapolis-St. Paul) exceeded 94 hours. Today B.N.'s eastbound TOFC train operates on a scheduled run of 67 hours. Our fastest train westbound from Chicago to Seattle operates on a scheduled run of 55 1/3 hours. Similar service improvements have been made elsewhere.

In The Interstate Commerce Omission, by Robert Fellmeth, Ralph Nader's study group report on the Interstate Commerce Commission and transportation, Grossman Publishers, New York 1970, at pages 81-82, the following observation is made:

> In the 'Northern Lines' case, the applicants stated at the initial hearing that the fastest Chicago to Seattle time by either the Great Northern or the

> Northern Pacific was 76 1/2 hours, and that the merger would reduce the time to 70 1/2 hours. By the time of the filing of the exceptions, the Northern Pacific had already pared its time to 58 1/2 hours, and the Great Northern to 59 1/2 hours. Obviously, this is another area where the ICC should look at railroad prognostications with great care, because predicted results are not proven results, and may be accomplished in any case without a merger.

It would appear, therefore, that the Ralph Nader group had concluded that the minimum time for an eastbound train was substantially less than what is now claimed as the direct result of the Northern Lines merger. The converse approach may be that after the reduction, which had already been accomplished by the time of the Burlington Northern merger on March 3, 1970, the carrier increased its running time between Seattle and Chicago. I thought it appropriate to point out to the Commission this claimed benefit from a marger when in fact it appears that the actual accomplishment of a merger resulted in an increased time on the eastbound train.

Very truly yours,

Patrick J. Foley

PJF:ch

cc:
Gordon Williams
James G. Dooley
W. A. Class, Jr.
Brian T. Johnson
C. H. Lindsey
J. R. Horn
G. P. Schiller
M. A. Duke
F. W. Kruger
Paul J. Johnson
M. M. Winter
Russell L. Olson
William G. Hougen
William Dunegan
Benjamin F. Tangeman

WIFE Women Involved In Farm Economics

TO THE SENATE COMMITTEE ON THE JUDICIARY-
RE-RAILROAD HOLDING COMPANIES.

My name is Mary Nielsen, of Medicine Lake Montana, where my husband and I have farmed for 35 years. For the past four years I have served as National Transportation Chairman for W.I.F.E.

W.I.F.E. is encouraged by the hearings to investigate the effects of the railroads forming holding companies.

In the 1977 Report to Congress by the I.C.C., entitled "Railroad Conglomerates and other Corporate Strctures", it becomes obvious that the holding company structure is a business venture that is no longer considering railroading- the movement of people and goods in this country- of major importance.

Our organization is becoming increasingly concerned with the effect that the increasingly high freight rates are having on the economy of both agriculture and the nation. This Administration has announced that it is endeavoring to fight inflation, and to get the economy back on an even keel. Yet it is ignoring the fact that agriculture is suffering the worst decline in income since the 1930's. It was that decline that led to the depression of the general economy in those years.

One of the worst of agriculture's problems is the high cost of moving our products to market. In some instances, it takes 1/3 of the price received for the commodity to ship it- and the farmer pays the freight costs. Agricultural producers also pay the cost of shipping on all they use, so we are doubly affected by increasing freight costs.

It is unbelievable that the Staggers Rail Act- giving the railroads almost unlimited freedom- could have been enacted in the light of that I.C.C. report to Congress. I can only assume that many Congressmen did not read it. In the conclusions of the report, the paragraph headings are strong indicators of what holding companies have done to transportation.

> "Advantages cited by the respondent holding companies as accruing to their subsidiary railroads have not yet become fully apparent."
>
> "The conglomerate structure has in the past and continues at present to have the potential of separating assets from railroad subsidiariesthrough various practices."
>
> "Holding company structures eliminate capital stock financing by

"Hell has no fury like a woman scorned"

page 2. W.I.F.E.

railroads."

"While there is as yet an apparent casual relationship between railroad corporate structure and the fortunes of the carriers as functioning entities despite the loss of substantial earning assets, the continuation of the asset separation poses a potential threat to the future health of the nations' rail system."

"The interests of conglomerate managements and their stockholders often diverge from the public interest in a sound transportation system."

On page 94, in the section "Ultimate recommendations and conclusions" the I.C.C. seems to have been frustrated in its efforts to be able to get authority from Congress to acquire the ability to investigate, not only the carriers, but also those- including holding companies- that already control the railroads. As a result of their study at that time, they obviously thought that that kind of authority was desirable.

The I.C.C. had hoped to be able, under their statutory powers, to compel the production of pertinent information by conducting examinations of not only the carrier, but also of the holding company and carrier affiliates, in order to identify any transactions between carrier and affiliate or parent company which might have a significant adverse impact upon the railroad.

Because of the recent actions of large railroad companies in setting up holding companies, and the freedoms given the carriers under the Staggers Rail Act, W.I.F.E urges that Congress give the Interstate Commerce Commissioninstructions to update the findings of that report, to find possible abuses of the railroad companies and its customers, by parent companies, and then act upon the findings.

We are also strongly in favor of at least part of the income from the lands given to any railroads by Congress and the States to operate and maintain rail transportation, beused for just that purpose. Had that been insisted upon in the first place, the holding companies would not be such a threat to rail transportation today.

Mary W. Nielsen

Mary W.Nielsen
April 13th 1982

AS AMENDED

A RESOLUTION ADOPTED BY THE
FIVE-STATE LEGISLATIVE CONFERENCE
RAPID CITY, SOUTH DAKOTA, SEPTEMBER 27-29, 1981

RESOLUTION

WHEREAS, certain United States railroads received a total of 128,000,000 acres of federal land to encourage and assist in railroad construction; and

WHEREAS, the total land grants enjoyed by the railroad displace 9.3 percent of the total land area of the United States, exclusive of Alaska and Hawaii; and

WHEREAS, the railroads receiving these land grants built about 18,000 miles of roadway, approximately eight percent of the total railroad mileage of the country; and

WHEREAS, four major western railroads, the Burlington Northern (through the Northern Pacific), the Union Pacific, the Southern Pacific, and the Sante Fe received 88 percent of the 128,000,000 acres; and

WHEREAS, the land grant railroads have retained ownership of some land and much of the mineral rights obtained through said land grants; and

WHEREAS, said land and mineral rights are extremely valuable and they contain farmland, coal, oil, gas, timber, and other resources; and

WHEREAS, the land grant railroads derive significant income from such land and mineral rights; and

WHEREAS, the land grant railroads have also formed holding companies to separate the land, mineral, and natural resource assets from their railroad operations; and

WHEREAS, the railroads (particularly Burlington Northern) have announced intentions to abandon a significant portion of branch line networks in the next few years; and

WHEREAS, rail transportation is vitally necessary to rural states to gather and ship bulk agricultural and other commodities; and

WHEREAS, the abandonment of branch lines will result in a shift in fiscal responsibilities from the private sector to the public sector to maintain a road and highway system;

NOW, THEREFORE, BE IT RESOLVED that the Five-State Legislative Conference and the respective state legislative branches of government in the five member states develop a cooperative effort to influence the retention of a sound railroad network by the land grant railroads and an efficient and economical operation of this system and the benefit of the citizens of those states; and

BE IT FURTHER RESOLVED that the Five-State Legislative Conference request that the United States Congress institute an investigation to accomplish the following:

-- Determine the value of the remaining land grant assets currently held by the railroads.

-- Determine the current income from land grant assets.

-- Determine the extent to which railroads require support of income from land grant assets to maintain and improve services, now and in the future.

-- Determine extent to which the Interstate Commerce Commission should permit necessary rail services to be abandoned in the light of government-provided land grant assets.

-- Establish a policy on diversion of land grant assets from "railroad" purposess.

-- Establish a policy that government-provided land grant assets and income from such assets should be included in the Interstate Commerce Commission determination of adequacy of revenues and earnings of the land grant railroads.

-- Examine the extent to which land grant assets and income should be used to replace government subsidy of necessary connecting services to land grant railroads; and

BE IT FURTHER RESOLVED that a copy of this resolution be sent to each member of the Congressional Delegation of the member states of the Five-State Legislative Conference and to the heads of the appropriate federal agencies.

Federal Aid to Railroads

PART III

Grants of Public Lands to Railroads

Jesse J. Friedman & Associates
Economic Consultants
Washington, D.C.
March 1980

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Jesse J. Friedman & Associates

This study was commissioned by
Water Transport Association
and American Waterways Operators, Inc.

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I

Introduction

Substantial grants of public lands in the nineteenth century to railroad builders, chiefly in the West, Midwest, and South, facilitated establishment and operation of important segments of the railroad network which now crisscrosses the United States and helped accelerate the pace of national economic integration and development.

This report examines that program of railroad land grants in the context of the aids which have been extended by Government to the various modes of transportation. It is the third installment of an extensive study of Federal programs which have been of major financial benefit to the railroad industry. The first two reports covered the large-scale subsidy assistance extended to the industry through direct and indirect government support of the pension system of the railroads and through the various Federal programs under which great amounts of Government capital have been and continue to be supplied to individual railroads.

Both of the previous reports dealt with Federal assistance programs of relatively recent vintage. Federal aid to the railroad retirement system on a substantial scale dates from 1950; the major programs of Federal capital assistance studied date from 1970. Although the land grants were made more than a hundred years ago, they are of more than mere historical interest with respect to their place and importance in the catalogue of Federal subsidy assistance to the railroad industry. The original grants were of great magnitude, comprising close to one-tenth of the entire land area of the continental

United States. Substantial acreages of these lands are still retained by the railroads or their affiliates. These properties are rich in oil, coal, timber, and other resources and, together with reserved mineral rights on grant lands previously sold, produce a large and rapidly rising flow of cash income.

Part II of the report recapitulates the basic history and terms of the railroad land grant programs, and reviews major controversies which have been associated with the grants. This historical review provides a background for the analysis of current issues relating to the land grants question.

Parts III and IV deal with specific aspects of the land grants that are particularly important from the standpoint of present-day Government policies toward the railroads. Part III examines the merits of the long-standing argument of the railroad industry that the rail rate reductions on Government traffic which were required until 1946 more than compensated the Government for the public lands given to the railroads. Part IV deals with the public policy questions raised by transfers of railroad grant lands and reserved mineral rights, and the earnings they produce, from the railroad companies themselves to holding companies or other affiliates having no public responsibility for railroad service.

Part V presents conclusions concerning the relevance of the value and income of railroad grant lands in considering comparisons of Federal assistance to the various modes of transportation and other matters of national transportation policy.

II

The Railroad Land Grant Program

Over a brief period of about two decades, from 1850 to 1871, an "empire" of 223 million acres of Federal and State lands was granted to railroad companies to encourage and assist railroad construction. The railroads receiving these land grants built about 18,000 miles of road—less than 8 percent of the total railroad mileage of the country.[1] A total of 174 million acres of lands came from the Federal public domain, either directly or by grants channeled through the states for the specific purpose of supporting proposed rail lines.[2] Federal grants of about 35 million acres were revoked or forfeited before the end of the nineteenth century because of failure to build or complete the roads as specified.[3] Another 3 million acres, held by the Southern Pacific, were revested in the Government under a 1916 statute enacted because of violation of grant conditions.[4] About 8 million acres of granted but unpatented land was returned to the Government under the Transportation Act of 1940 as a condition of partially surrendering its right to preferential rail rate reductions on Government traffic; in 1946 this right was surrendered in full.[5] Thus, the net amount of Federal land received by the railroads under the land grant program was about 128 million acres.

The railroads comprising four present-day railroad systems, all in the West, received 88 percent of the 128 million acres of

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[1] Vernon Carstensen, ed., "The Public Lands: Studies in the History of the Public Domain", University of Wisconsin Press, Madison, 1968, p. 130-146.

[2] David M. Ellis, "The Forfeiture of Railroad Land Grants, 1867-1894", in Mississippi Valley Historical Review, June 1946, p. 27.

[3] Carstensen, *op. cit.*, p. 150-151.

[4] Board of Investigation and Research, "Public Aids to Domestic Transportation", House Document No. 159, 79th Congress, 1st Session, 1945, p. 110.

[5] Carstensen, *op. cit.*, p. 146.

Federal lands. These four systems are the Burlington Northern, the Southern Pacific, the Union Pacific and the Santa Fe. The roads making up the present Burlington Northern, successor to the Northern Pacific, which alone received some 40 million acres, accounts for about 35 percent of the total Federal lands granted to all railroads. The Missouri Pacific and the Southern Pacific were the largest beneficiaries of the public lands granted by the states, accounting between them for approximately one-half of the entire state total.[7]

In addition to the lands granted directly by the Federal Government, some of which were channeled through the states, nine states aided railroad construction by making their own grants totaling 49 million acres; Texas alone granted 33 million acres from its own public land domain which it had retained when it entered the Union.[6]

The total of the net amount of the Federal lands and the State lands granted to the railroads was 177 million acres. By comparison, the land area of the continental (48) United States totals about 1,900 million acres. Thus, the land grants enjoyed by the railroads represent 9.3 percent of the total land area of the U.S. exclusive of Alaska and Hawaii.

The grants covered great portions of various states and lesser portions of others. Combined Federal and State grants to the railroads, net of all forfeitures, revocations, and revestments, encompassed 32 percent of the land area of Florida; 24 percent of the land area of Minnesota and of North Dakota; 22 percent of Washington; 20 percent of Texas; 16 percent of Montana, of Nebraska, and of Kansas; 15 percent of Iowa; 13 percent of Michigan; 12 percent of California; 11 percent of Arizona and of Wisconsin; 10 percent of Arkansas; 9 percent of Wyoming; 8 percent of Nevada and of Alabama; 6 percent of Colorado; 5 percent of Missouri and of Louisiana; 4 percent of New Mexico, of Utah, of Maine, and of Mississippi; and 1 to 2.5 percent of Idaho, of Oregon, and of South Dakota. (Table 1 and Map 1)

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[6] Board of Investigation and Research, *op. cit.*, p. 109-110.

[7] Board of Investigation and Research, *op. cit.*, p. 111.

The railroad land grants noted above were in addition to the public lands conveyed for use in right-of-way construction itself and consisted of blocks of between 6 and 20 square miles alternating in checkerboard fashion along the railroad lines.

Most of the land grants were subject to a provision excluding mineral bearing lands. Exempted from this exclusion, however, were lands containing coal and iron reserves, presumably because of the connection of these commodities with the needs of railway construction and operation. The exemption of coal lands from the mineral lands exclusion was to prove extremely beneficial to such railroads as the Northern Pacific (now part of the Burlington Northern), the Union Pacific, and the Santa Fe because of the enormous coal reserves on their grant lands. To the extent that lands in the grant areas proved unavailable, typically because of prior claims of settlers or the exclusion of mineral lands, the railroads were awarded substitute grants in adjoining areas. In addition to aid in the form of the granted lands, the railroads were given virtually unlimited free access to adjacent Federal lands for timber, stone, and other materials needed for constructing the roads. They also received considerable direct and indirect financial help from the Government.

Most of the lands conveyed from the public domain to the railroads were sold by them over an extended period, although mineral rights were reserved. Several million acres of grant lands are still retained today and mineral rights are owned on several million acres more. Practically all of these holdings are in the hands of the four major Western systems or their affiliates.[8]

The history of the railroad land grants is replete with controversies arising from railroad failures to comply with the terms of the grants, Government efforts to recapture granted lands because of such failures, the determination of the railroads to enforce their rights in the face of settler claims and Indian treaties, and recurrent allegations of exploitation, misrepresentation, and fraud.

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[8] Ibid., p. 117.

MAP 1

Total Federal and State Land Grants to Railroads, By State in Proportion to Land Area of Each State

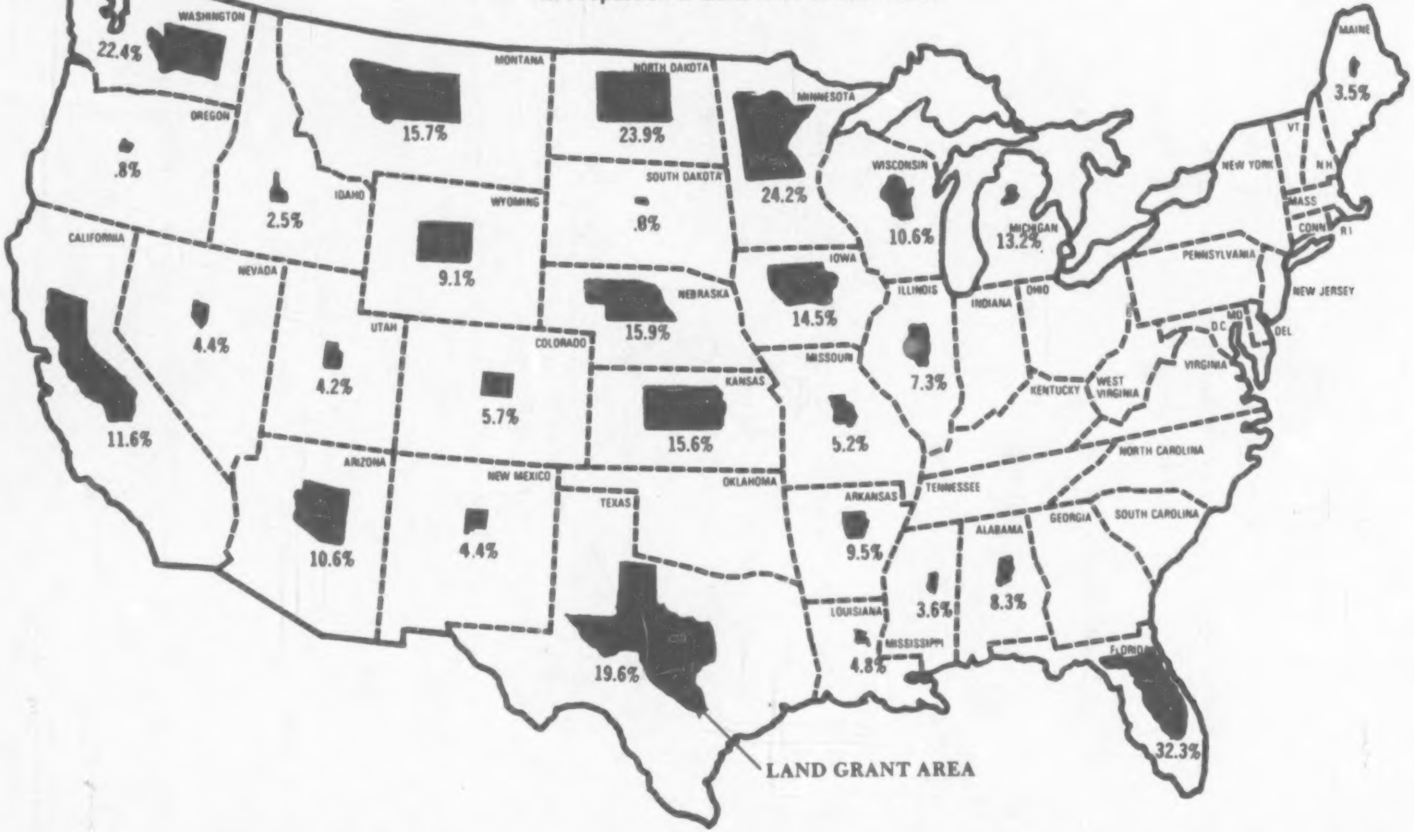
WASHINGTON
22.4%
OREGON
.8%
CALIFORNIA
11.6%
IDAHO
2.5%
NEVADA
4.4%
MONTANA
15.7%
WYOMING
9.1%
UTAH
4.2%
ARIZONA
10.6%
COLORADO
5.7%
NEW MEXICO
4.4%
NORTH DAKOTA
23.9%
SOUTH DAKOTA
.8%
NEBRASKA
15.9%
KANSAS
15.6%
OKLAHOMA
TEXAS
19.6%
MINNESOTA
24.2%
IOWA
14.5%
MISSOURI
5.2%
ARKANSAS
9.5%
LOUISIANA
4.8%
WISCONSIN
10.6%
ILLINOIS
7.3%
MISSISSIPPI
3.6%
MICHIGAN
13.2%
INDIANA
OHIO
KENTUCKY
TENNESSEE
ALABAMA
8.3%
GEORGIA
FLORIDA
32.3%
SOUTH CAROLINA
NORTH CAROLINA
WEST VIRGINIA
VIRGINIA
D C
MD
DEL
PENNSYLVANIA
NEW JERSEY
NEW YORK
CONN
R I
MASS
VT
N H
MAINE
3.5%
LAND GRANT AREA

TABLE 1

Federal and State Land Grants to Railroads, by State Net of Forfeitures, Revocations, and Revestments

(million acres)

State	Total Land Area	Area of Land Grants			Total Land Grants As Percent of Total Land Area
		Total Grants	Federal	State	
Alabama	32.7	2.7	2.7		8.3%
Arizona	72.7	7.7	7.7		10.6
Arkansas	33.7	3.2	2.6	.6	9.5
California	100.4	11.6	11.6		11.6
Colorado	66.5	3.8	3.8		5.7
Florida	34.7	11.2	2.2	9.0	32.3
Idaho	53.0	1.3	1.3		2.5
Illinois	35.8	2.6	2.6		7.3
Iowa	35.8	5.2	4.7	.5	14.5
Kansas	52.6	8.2	8.2		15.6
Louisiana	28.9	1.4	1.4		4.8
Maine	19.9	.7		.7	3.5
Michigan	36.5	4.8	3.1	1.7	13.2
Minnesota	51.2	12.4	9.5	2.9	24.2
Mississippi	30.3	1.1	1.1		3.6
Missouri	44.3	2.3	2.3		5.2
Montana	93.6	14.7	14.7		15.7
Nebraska	49.1	7.8	7.3	.5	15.9
Nevada	70.3	5.1	5.1		4.4
New Mexico	77.8	3.4	3.4		4.4
North Dakota	44.8	10.7	10.7		23.9
Oregon	61.7	.7	.7		.8
South Dakota	49.0	.4	.4		.8
Texas	168.7	33.0		33.0	19.6
Utah	52.7	2.2	2.2		4.2
Washington	42.9	9.6	9.6		22.4
Wisconsin	35.0	3.7	3.7		10.6
Wyoming	62.4	5.7	5.7		9.1
Total of grant states	1,559.2	177.2	128.3	48.9	11.4
Total, continental U.S. (48 states)	**1,905.4**	**177.2**	**128.3**	**48.9**	**9.3**

SOURCE: Bureau of The Census; Report of Commissioner of General Land Office, June 30, 1943; "Public Aids to Transportation, Volume II, Aids to Railroads and Related Subjects," Federal Coordinator of Transportation, 1938.

One noted historian has referred to "the controversial history of the land grants from the Civil War to the present day: the revulsion of public sentiment which by 1871 forced Congress to refuse additional grants; the groundswell of public opinion which throughout the 1880's demanded the recovery of grants to companies failing to observe the requirements of the law; the endless litigation which surrounded almost every clause in the grants; the vexatious delays which marred the administration by the General Land Office; the interminable debates in Congress which accompanied every effort to recover unearned grants. . . ."[8a]

A continual source of railroad friction with the communities through which they operated was the dilatoriness of the railroads in patenting granted lands, for the purpose of avoiding the payment of local property taxes.[9]

Criticism of the railroads also arose from abuse of the right to take timber from public lands for railroad construction use:

> "Another evil arising from the railroad grants, to which attention was pointedly called for the first time in 1885, was the distortion of railway rights to provide grounds for extensive timber depredation. In every law conferring a subsidy or even a mere right-of-way, the beneficiary was given the privilege of taking necessary materials for construction from adjacent public lands. His investigation of the operation of this provision led (Land Office Commissioner) Sparks to remark that the grantees used the word 'adjacent' to mean practically anywhere in the United States . . .
>
> . . . In 1887 the government secured a judicial definition of 'adjacent' as the ordinary distance of wagon transportation. These steps may have stopped some of the exploitation of public property, but it is doubtful if the machinery of enforcement was sufficiently effective to accomplish all that was necessary.

[8a] Ellis, op. cit., p. 27.

[9] Ibid., p. 32

> "A related problem, somewhat more difficult of solution, was that of timber-cutting on unearned railroad lands. . . . [T]he depredations continued, and Sparks observed that the failure of Congress to forfeit unearned grants had been the cause of wholesale destruction of the timber."[10]

Perhaps the most frequently criticized aspect of railroad conduct associated with the land grant program was that involving railroad-settler relations.

> "[R]ailroad land policies were rarely free from attack. Complaints were made that the prices were too high, that companies sometimes took advantage of the law to deny settlers preemption rights, that to avoid patent and consequently taxes they delayed paying the surveying and conveyance costs, and that their delays in establishing routes and selecting lands kept at least twice the amount of land they were entitled to out of development, and that their influence at the Land Office was all-powerful."[11]

A reform-minded Commissioner of the Land Office commented upon a recurrent cause of conflict as follows:

> "Lands to which a settlement right existed, or to which a homestead or preemption claim had been filed at the date of the grant or the attachment of the railroad right, were absolutely excepted from the grant. The validity or invalidity of the claim as against the United States was not in question. Railroad companies were not empowered to challenge the settler's right, to criticize his compliance with the law, or to dispute the effect of claims of record. Such lands were not granted to the roads, which were allowed other lands in lieu of them. But the agents and attorneys of railroad companies have been permitted to antagonize settlement claims at every point and in every stage, until

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[10] John B. Rae, "The Development of Railway Land Subsidy Policy in the United States", Arno Press (New York Times Company), New York, 1979, p. 295-296.

[11] Robert W. Swenson, "Land Grants for Railroads and Internal Improvements", in Paul W. Gates, "History of Public Land Law Development", U.S. Public Land Law Review Commission, Washington, D.C., 1968, p. 379.

> it became easier for claimants to buy the land from the railroads."[12]

One of the most far-reaching controversies with respect to the lands granted to the railroads during the nineteenth century arose in connection with the "settlement and preemption" proviso which Congress attached to various grants in line with established Government policy against land monopoly and speculation. The most important grants containing this proviso were those given to the Union Pacific and Central Pacific under the Pacific Railroad Act of 1862. These grants, as ultimately adjusted, comprised more than 26 million acres.[13]

The settlement and preemption clause provided that all lands not "sold or otherwise disposed of" within three years after completion of the railroad lines in question were to be opened to settlement and preemption at a price of $1.25 an acre in accordance with earlier statutes relating to use of the public domain:

> "And all such lands, so granted by this section, which shall not be sold or disposed of by said company within three years after the entire road shall have been completed, shall be subject to settlement and preemption, like other lands, at a price not exceeding one dollar and twenty-five cents per acre, to be paid to said company."[14]

In an early case on the subject, a branch of the Union Pacific used the clause to its advantage by arguing that although it had failed to pay Kansas state taxes on lands granted to it but not yet patented, the settlement and preemption objective of Congress would be defeated if the state were permitted to foreclose and dispose of the property for delinquent taxes. The Supreme Court, in holding for the railroad, said:

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[12] U.S. Department of the Interior Land Office Reports, 1885, p. 188. Rae (*op. cit.* p. 326) offers another perspective on this question: "(E)ven with an adequate organization, the General Land Office would have found it an arduous task to restrain the rapacity of the various interests engaged in appropriating the public domain. This trait was by no means confined to the railways, although they were freely accused of ruthlessly depriving settlers of their rights with the connivance of corrupt or compliant government officials. The facts of the matter show that settlers were, as a class, amply able to look after their own interests, even if the requirements of the land laws had occasionally to be disregarded in the process."

[13] Legal Analysis of "Administrative Complaint" Filed with Department of the Interior by the Coalition for Land Reform and the California Coalition of Seasonal and Migrant Farm Workers, Relative to the Federal Land Grants, 1850 to 1871, October 14, 1976, p. 60.

[14] Pacific Railroad Act, 12 Stat. 492, Section Three.

> "It is wisely provided that these lands shall not be used by the company as a monopoly of indefinite duration. The policy of the government has been for years to encourage settlement on the public land. . . ."[15]

The issue subsequently arose more directly in connection with an application by a would-be settler to preempt a tract of the Union Pacific land grant remaining unsold several years after the 3-year time limitation following the railroad's completion had passed. Secretary of the Interior Schurz rejected the railroad argument that a mortgage which it had placed on the lands in question was a disposition within the meaning of the proviso and thus was a bar to making the property available for settlement and preemption. Schurz ruled that the land had to be turned over to the applicant:

> "It was clearly not the intention of Congress that so large a body of land as that granted by this act should remain under the control of any corporation for an indefinite period of time, and to prevent such a result the time within which the company or companies might have the exclusive sale of the lands was limited. . . .
>
> "Congress did not intend that the lands granted should be sold at speculative prices, nor that they should be kept in large quantities out of the market for an unreasonable length of time."[16]

Within weeks after this decision, which threatened to open all the Union Pacific's unsold land to settlement and preemption at $1.25 an acre, the railroad precipitated a new suit directly in the Federal courts. The Attorney General, who entered the case on behalf of the Government, argued that "the failure of the company to sell within the appointed time vested the legal title to the lands in the United States." The case turned on this key question:

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[15] Railway Co. vs. Prescott, 83 U.S. 373, 374 (1873).

[16] Dudymott vs. Kansas Pacific R.R. Co., Annual Report of the Secretary of the Interior for 1878, p. 73.

> "[T]he Company issued their coupon bonds for the sum in the aggregate of $10,400,000, bearing seven percent interest and payable in twenty years. . . . The instrument . . . was substantially a mortgage. . . . The bonds were sold in different markets to *bona fide* purchasers, and they are now outstanding, about $7,000,000 still remaining unsatisfied. . . . Was the mortgage a sale or disposition of the lands as understood by Congress?"[17]

In a 6-3 decision, the Supreme Court held for the railroad, stating:

> "[T]he *paramount* intention of Congress was to give such assistance to the Company as to induce them to build the road. . . . Congress must have been blind, indeed, if it did not . . . intend to authorize the use of the lands to raise money by mortgage for the object it had so much at heart. This, we think, was what was intended by the phrase 'or disposed of', as distinguished from 'sold'. . . . We are constrained to hold that the mortgage of 1867 was a disposition of the lands mortgaged within the meaning of the statute, and, consequently, that the tract of land claimed by the complainant was not open to preemption. . . ."[18]

The contrary view put forth by the dissenting justices is also worth noting:

> " . . Congress had in view such a sale and disposition of the lands as would secure a settlement thereof. The object was to encourage a speedy settlement of the country along the line of the road. . . . If the Company, by one sweeping deed of trust, or mortgage, could cover the whole domain as with a blanket, and thus prevent a settlement thereon until the lands, by advance of prices, would be out of the reach of actual settlers desirous of occupying and

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[17] Platt vs. Union Pacific R.R. Co., 98 U.S. 424, 426 (1878).

[18] Ibid., p. 428.

> improving them . . . it would entirely defeat the objects of the Act."[19]

Thus, by a slim margin, on the technical point of whether a mortgage fell within the definition of "sold or disposed of", the Union Pacific Railroad—along with other railroads subject to similar clauses—was able to retain millions of acres of land grants without having to open them to settlement and preemption.

The favorable popular sentiment which the railroads had succeeded in generating during the feverish period of land grant awards by Congress did not endure for long. It was soon to be succeeded by even more feverish anti-railroad feeling:

> "By the eighties the railroads everywhere had fallen from their high position into public disgrace. No economic institution had earlier been so pampered, so liberally showered with grants of charters, rights of way through public property, rights of eminent domain, imperial land donations, and financial subventions by Federal, state, county, and municipal governments. Railroad officers had been publicly feted, their word had become law in many communities, legislatures and executive figures waited on their convenience, their power seemed invincible. The tide had turned against them in the West when their grab for land, their unwillingness to pay taxes, their efforts to extract every possible dollar from their holdings, brought them into conflict with the homesteader and with small-town business interests. Railroad land- and tax-policies were as important as the rate-structure, perhaps more so, in bringing about this revulsion of opinion. The donations of land were now regarded by the agrarian-minded people as a serious mistake. . . .[20]

Growing public resentment against the railroads led to widespread support for legal action by the government to recover substantial acreages of granted lands. This movement produced a succession of enactments by Congress between 1870 and 1890 providing in total for the forfeiture of about 35 million acres of lands which had been granted to the railroads for construction of lines which had never been built. Far more drastic measures, providing for the forfeiture of an additional 50 to 70 million acres in cases where construction time limitations had been breached, received impressive support and were vigorously pressed in Congress on several occasions but, while winning overwhelming House approval, failed to pass in the Senate and eventually died.

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[19] Ibid., p. 430.

[20] Paul W. Gates, "Fifty Million Acres: Conflicts Over Kansas Land Policy, 1854-1890", Cornell University Press, Ithaca, 1954, p. 293-294.

Early in the twentieth century, the forfeiture question again became a burning issue in connection with the land grant which had been assigned to the Oregon and California Railroad, a company subsequently taken over by the Southern Pacific. This was one of the most bitterly-fought battles in railroad land grant history. "The land grant received by the Oregon and California Railroad has probably stirred up more controversy over a longer period of time than any other land grant—always excepting the gigantic grant to the Northern Pacific railway."[21]

The forfeiture issue arose from public dissatisfaction with railroad behavior regarding the rich timber stands on those lands. Under the terms of the original grant of 3.8 million acres, the railroad was bound by a requirement that the land should be sold only to actual settlers, in tracts of no more than 160 acres and at prices not above $2.50 an acre.

Congress had granted these lands to the State of Oregon expressly to aid in construction of railroads from the Columbia River near Portland to the California line and from Portland to Astoria. Numerous violations of the terms of the land grant had gone unchallenged until "Edward H. Harriman, who controlled the Union Pacific and the Southern Pacific Companies, made an ill-fated announcement to the effect that as of January 1, 1903, no further Government lands were to be sold. Lands were to be maintained as a timber reserve for the company. While illegal sales of land might be overlooked by the populace, discontinuance of such sales and the impediment to the 'development of the West' could not be."[22]

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[21] David M. Ellis, "The Oregon and California Railroad Land Grant, 1866-1945", in Pacific Northwest Quarterly, October 1948, p. 253. Some of the reasons for the bitterness generated by the Northern Pacific grant have been noted as follows: "Because of the huge size of its land grant — 23 percent of North Dakota, 15 percent of Montana — which was brought into market and sold very slowly, and because the company delayed in taking out its titles and making its lands taxable, the Northern Pacific Railroad came under a concerted attack by agrarians, anti-railroad people, and heavy tax payers who wanted to have their burden shared." Swenson, *op. cit.*, p. 375. See also p. 20-25 below.

In his *History of The Southern Pacific*, Daggett has summarized what occurred:

> ". . . Now the simple facts with regard to the company's administration of this estate are that it did not limit the price which it charged to $2.50 per acre, that it took no pains to ascertain whether or not purchasers of its lands were actual settlers, and that it sold in whatever quantities were convenient from the point of view of revenue. Between 1894 and 1903, to take the period when the company neglected its obligations most grossly, there were sales at prices ranging from $5 to $40 an acre, and in amounts which in one instance reached the figure of 45,000 acres to a single purchaser. Out of 820,000 acres sold during this period, approximately 370,000 were sold to 38 purchasers in quantities exceeding 2,000 acres to each purchaser, and at prices higher than $2.50. These sales, according to the Supreme Court, were to persons other than actual settlers, and for other purposes than settlement. On January 1, 1903, the company reached the climax of its disobedience to law by withdrawing all of its lands from sale and refusing to accept offers for any of them, asserting that they were timber lands and unsuitable for settlement. . . ."[23]

The essence of the matter was that the railroad "found that its grant was largely valuable for the timber on it. The directors callously and perhaps realistically disregarded the provisions. . . .[24]

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[22] Christian C. Basler, "The O&C Lands", U.S. Department of the Interior, Bureau of Land Management, 1965, p. 2.

[23] Stuart M. Daggett, "Chapters in the History of the Southern Pacific", Ronald Press, New York, 1922, p. 451.

A stubborn and drawn-out legal campaign by the Southern Pacific to prevent enforcement of the restriction contained in the land grant proved fruitless when the Supreme Court eventually declared the restriction binding.[25] Congress in 1916 enacted a statute repossessing the unsold lands, which aggregated close to 3 million acres, with compensation to the railroad fixed at $2.50 per acre to the extent that this value exceeded the proceeds already realized by the railroad.

Summing up the significance of this chapter of railroad land grant history, the author of a study published by the Senate Interior Committee has written:

> ". . . [T]he Southern Pacific might have escaped censure and forfeiture had it not overplayed its hand. . . . Attempting to capitalize (figuratively and literally) on a tremendous rise in timber value, the Southern Pacific misjudged the temper of the time in the first decade of the 20th century and lost the remainder of the grant. The cycle had run full course from grant through construction to revestment, the only grant to run such full course."[26]

In another fiercely-contested episode involving the Southern Pacific, the Government challenged the right of the railroad to retain the rich oil lands it held as part of Federal land grants it had received. The original land grants, as was true of almost all railroad land grants, had excluded mineral lands from the grants, other than coal and iron lands. In an earlier test case brought by a private party, the Supreme Court had held that oil was included within the definition of "mineral" but that, regardless of the exclusion of mineral lands from the grant, the Southern Pacific's title to already-patented oil lands could not be upset except on a showing of fraud.[27]

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[24] Ellis, "The Forfeiture of Land Grants", *op. cit.*, p. 59.

[25] Oregon and California Railroad Company vs. United States, 238 U.S. 393 (1915).

[26] Jerry A. O'Callaghan, "The Disposition of the Public Domain in Oregon", U.S. Senate, Committee on Interior and Insular Affairs, Washington, D.C., 1960, p. 42-46. (Committee Print).

The Government's suits undertook to make such a showing. The first of these suits involved the right of the Southern Pacific to retain its title to about 6,000 acres of oil land in the Elk Hills region of Southern California. A second series of suits involved about 165,000 acres, alleged by the Government to have a value of more than $420 million, held by the Southern Pacific under various land grants.[28]

A key issue in these far-reaching cases was the conduct of railroad officials. Under the terms of the land grants and of Interior Department regulations the authorized land agent of the railroad, in applying for the issuance of patent to the granted lands, was required to make affidavit that he had caused the lands in question "to be carefully examined by the agents and employees of the company as to their mineral character, and that to the best of his knowledge and belief none of the lands returned in the list are mineral lands."[29] In the Elk Hills case, the Supreme Court found in November 1919 that the Southern Pacific had made fraudulent representations concerning the mineral character of the land, and ordered cancellation of the railroad's title.[30] In the remaining cases, tried on a consolidated basis, a District Court decision that the evidence was not sufficient to support the fraud allegations was not appealed by the Government.[31]

Professor Daggett has described the relevant circumstances and outcome of the Southern Pacific oil-land cases as follows:

> ". . . Counsel [for the government] alleged that the company's land agents . . . had accompanied the lists, which they had submitted to the government for patenting, with affidavits stating that the lands were not mineral

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[27] Burke vs. Southern Pacific, 234 U.S. 669 (1914)

[28] U.S. Federal Coordinator of Transportation, "Public Aid to Transportation", Vol. II, Washington, D.C., 1938, p. 31.

[29] United States vs. Southern Pacific Company, *et al*, (District Court, N.D., California) 260 Fed. 511, 516 (1919).

[30] United States vs. Southern Pacific Co., 251 U.S. 1 (1919).

[31] United States vs. Southern Pacific Co., 260 Fed. 511 (1919).

lands, although both agents knew at the time the patents were applied for that the lands in question contained oil. This charge, if substantiated, amounted to a showing of fraud. In both cases the government sought to show that the presence of oil upon the lands sought was a matter of common knowledge, and that there was reason to believe that the company was fully cognizant of the facts.

"Most of the sensational testimony taken in the oil land cases appeared in the so-called Elk Hills case. . . . [T]he land agent for the Southern Pacific . . . had filed an affidavit with the Land Office in November, 1903, in which he swore to two pertinent facts: first, that he had caused the lands for which the railroad applied to be carefully examined by the agents and employees of the company as to their mineral or agricultural character; and second, that to the best of his knowledge and belief, none of the lands returned in the list were mineral lands. These statements had been repeated in September, 1904, when a substitute list was filed.

"In the face of these sworn assertions, the United States Supreme Court later found that (the land agent) had not examined the lands in question, nor had he caused them to be examined by others. Indeed, (he) had even objected to the examination of the lands. . . .

"Besides falsely swearing that he had made an examination of the lands involved in the Elk Hills case, (the land agent) made the positive statement in his affidavit that none of the lands covered by his application were mineral lands, in so far as he was informed. Now in this matter it is clear that the evidence before him, such as it was, pointed to a mineral and not to a non-mineral content of the land in question. This evidence consisted primarily in the results of work of Southern Pacific geologists in the general region of which the Elk Hills were a part, and in the presence there of a certain number of producing wells. It is on record that in 1902 the Southern Pacific withdrew from the sale many of its patented lands which surrounded or were adjacent to the land in controversy 'because they were in or near oil territory'. . . .

". . . Summing up the evidence in the case, the United

> States Supreme Court later observed that the natural, if not the only, conclusion from the facts was that in pressing the selection the officers of the railroad company were not acting in good faith, but were attempting to obtain the patent by representing that the lands (covered by the Elk Hills litigation) were not mineral when they believed the fact was otherwise."[32]

In still another hotly-contested dispute that extended over many years, the Northern Pacific sought to force the Government to convey some 4 million acres of indemnity land to which the railroad claimed it was entitled in substitution for a corresponding acreage which had been included in the original grant area but had proved unavailable to the railroad because of prior settler claims and the like. Much of the indemnity land sought by the railroad was within the boundaries of national forests. A Supreme Court decision in 1921, which was favorable to the railroad claim, led early in 1924 to a request by President Coolidge that Congress undertake a comprehensive investigation of the Northern Pacific land grant and determine what legislation, if any, was needed to protect the public interest. President Coolidge's message transmitted a letter from the Secretary of Agriculture containing what the President described as "a summary of the facts involved in this matter, as they have been developed through a painstaking investigation":

> "1. That the land grants were made for the purpose of aiding in the construction of the railroad. The total gross receipts of the Northern Pacific to June 30, 1917, from the sale of the lands from its grant amounted to $136,118,533.14. The cost of constructing the road did not exceed $70,000,000. The sale of lands has more than paid for the cost of constructing the railroad.
>
> "2. That the Northern Pacific failed to construct 1,507.21 miles of its railroad within the time required by law, there-

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[32] Daggett, *op. cit.*, p. 445-448.

by rendering the granted lands subject to forfeiture.

"3. That the Northern Pacific failed to dispose of certain of its lands to settlers at not to exceed $2.50 per acre as required by the law. A somewhat similar provision in the Oregon and California grant was held by the Supreme Court to be an enforceable covenant (238 U.S. 393).

"4. That the Northern Pacific failed to dispose of hundreds of thousands of acres of its lands at public sale, as required by law.

"5. That hundreds of thousands of acres of poor land in the Northern Pacific grant were erroneously classified as mineral. This land was turned back to the United States and the railroad acquired mineral indemnity rights therefor, which were applied in part on more valuable lands in the indemnity limits.

"6. That under a rule of law laid down by the Supreme Court the Northern Pacific has been erroneously allowed 1,500,000 acres too much land in the State of Washington.

"7. That over 500,000 acres of land credited to the Northern Pacific should be deducted because of conflict with the land grant of another raod and the erroneous fixation of the land-grant limit lines.

"8. That approximately 640,000 acres of land have been erroneously allowed the Northern Pacific by reason of the Tacoma overlap.

"9. That the Northern Pacific has received approximately 600,000 acres of land to which they were not entitled under their grant in the Wallula overlap.

"10. That the Northern Pacific has been allowed to make over 1,300,000 acres of indemnity selections in its second indemnity belt, whereas these selections should have been confined to the first indemnity belt.

"11. That for lands erroneously patented to the Northern Pacific the Government should be entitled to receive at least what the railroad received from the sale of these lands instead of $1.25 per acre.

> "12. That the Northern Pacific, under the Mount Rainier Park act of March 2, 1899, relinquished to the United States thousands of acres of commercially valueless land and received therefor selection privileges applicable to the finest lands they could find in the States of Oregon, Washington, Idaho, Montana, North Dakota, Minnesota, and Wisconsin. . . ."[33]

The response of Congress to the President's message was enactment of a joint resolution establishing a Joint Congressional Committee on the Investigation of the Northern Pacific Railroad Land Grants. The resolution directed the Secretary of the Interior to withhold transferring the disputed lands to the railroad "until after Congress shall have made a full and complete inquiry into the said land grants and the acts supplemental thereto for the purpose of considering legislation to meet the respective rights of the Northern Pacific Railroad Company and its successors and the United States in the premises."[34]

After five years of study by the Joint Committee, Congress authorized the Attorney General to institute an action in the courts "to remove the cloud cast by the claims of the Northern Pacific Railway Company on the title of the United States to approximately 2.9 million acres of land which had been withdrawn by the United States for its own purpose and which were located in the indemnity limits of the land grants made to the Northern Pacific. . . ."[35]

The suit filed by the Government asserted legal ownership of the lands being sought by the railroad, and charged that the railroad, because it had breached terms, conditions, and covenants of the granting acts and was guilty of fraud in their administration, had no legitimate claim to the lands in question. The Government also asked for an award of damages for the value of lands erroneously patented to the railroad. The railroad, in turn, asserted an equitable title in the disputed lands, argued that its title had been expropriated by the Government, and asked for a judgment for the amount due it as a result of such expropriation.

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[33] Joint Congressional Committee on the Investigation of the Northern Pacific Land Grants, Hearings, March 18, 1925, p. 6-7.

[34] Joint Resolution, June 5, 1924, 43 Stat. at L. 461.

[35] Act of June 25, 1929, 46 Stat. at L. 41.

The District Court held that the railroad was entitled to compensation for about 1,453,000 acres of the lands which had been withdrawn by the Government and to patents to an additional 429,000 acres, and that the Government was entitled to compensation for 66,000 acres of lands erroneously patented to the railroad.

The Supreme Court affirmed these awards but remanded the case with instructions to restore those charges which had been made by the Government, and stricken by the lower court, with regard to railroad fraud and breach of the provisions of the land grants. The Government had charged that the alleged fraud, if established, would disentitle the company to more than a million acres of the lands for which the lower court had awarded it compensation, and the Supreme Court decision insured to the Government an opportunity to prove the fraud charges. Also, the United States had alleged that the Northern Pacific had breached a basic requirement of the land grant by failing to open to settlement and preemption at prices not exceeding $2.50 an acre all grant lands which had not been sold or disposed of within 5 years following completion of the road; the lower court had dismissed these allegations but the Supreme Court reinstated them and permitted the Government to undertake to prove the damages occasioned by the breach.

The Supreme Court action left the case in an interesting posture. On the one hand, the railroad was subject to risk with respect to the charges of fraud and breach. On the other hand, at least with regard to the question of determining damages, the Government's problems of developing the necessary evidence were formidable.

At this juncture, the railroad proposed a settlement of the suit under which all claims on both sides were dropped, the fraud and damage charges were mooted, and the railroad consented to a small money judgment in favor of the Government. Reviewing the case in an historical perspective almost thirty years later, Professor Ellis observed: "The Northern Pacific decided to surrender. No doubt its officers feared the threat of conviction for fraud. Perhaps the prospect of another decade of law suits made them eager to close the books."[36] The railroad's proposal was accepted by the Attorney General and approved by the court, closing the case.[37]

More recently, a formal effort was made by a land reform group in California to have the Government undertake a wide-ranging investigation of the failure of all the railroads in the West to comply with the terms of their land grants.

Citing particularly the record of the Southern Pacific with respect to several million acres of land now being devoted to oil, timber, agricultural production, and other non-railroad uses, the petitioners argued that "railroads are currently holding grant lands which their original grants required them to sell to the public subject to maximum size and price limitations or forbid them to exploit commercially as they now appear to be doing", and that "the passage of time does not excuse land grant violations." The petitioners argued that the Secretary of the Interior should launch a broad inquiry into "the status of the railroad land grants and the disposition of the railroad lands to ascertain the extent of non-compliance with land grant conditions", and that such an investigation would demonstrate the propriety of these remedies:

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[36] David M. Ellis, "The Homestead Clause in Railroad Land Grants", in Ellis, ed., "The Frontier in American Development", Cornell University Press, Ithaca, 1969, p. 71.

[37] In determining that the settlement was a reasonable one from the Government's standpoint, Judge Schwellenbach noted that "this case . . . has two characteristics which are not usually found in ordinary litigation. In the first place the public interest is involved to a very high degree and, second, the action was started in compliance with an Act of the Congress . . ." The Judge observed that the Government was in a position that "we so often find in cases of litigation where one has a perfectly sound lawsuit and cannot prove it, and I do not believe it would ever be possible for the Government to go back these manys years and prove either of the necessary facts in order to recover damages, or what its measure of damages is." United States vs. Northern Pacific Railway Co., 41 F. Supp. 273, 283 (1941).

> "1. An administrative or court order requiring the railroads to make available to petitioners and others similarly situated a reasonable amount of arable land at prices not to exceed $2.50 an acre.
>
> 2. Forfeiture by said railroads to the Federal Government of lands held in violation of law. Such land would then enter the public domain and be opened to settlement under the Homestead and related acts, or retained for national forests, wildlife refuges, open spaces, and other uses in the public interest.
>
> 3. An counting for and reimbursement to the general treasury by said railroads of all profits made from uses of such lands prohibited by the land grant laws." [38]

In asking for denial of the petition, the Southern Pacific took the following position:

> "(1) That the Interior Department has no jurisdiction to make the requested investigation;
>
> (2) That the charges of current violations of the Southern Pacific land grant acts are completely without merit;
>
> (3) That in any event the United States at this late date, under applicable laws and the Fifth Amendment to the Federal Constitution, is powerless to impose, with respect to any land granted to Southern Pacific or any other railroad, a forfeiture, an accounting with respect to profits, a forced sale to others, or to retake any of such land by any means short of condemnation and payment of its full value;
>
> (4) That, furthermore, it would be extremely inequitable for the United States to exercise any of the procedures requested in the complaint with respect to the Southern Pacific grant land or to that of any other railroad. . . ." [39]

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[38] Administrative Complaint by National Coalition for Land Reform and California Coalition of Seasonal and Migrant Farm Workers, U.S. Department of the Interior, June 21, 1972, p. 17.

[39] Reply to Administrative Complaint on Behalf of Southern Pacific Transportation Company and Southern Pacific Land Company, U.S. Department of the Interior, August 31, 1972, p. 3.

Southern Pacific's puzzling reference to the Fifth Amendment was not explained in the body of the reply.

In their response to the Southern Pacific reply, the petitioners emphasized that "the land grant railroads cannot deny that retained grant lands are now being used solely to generate revenues, a purpose never contemplated by Congress when it enacted statutes granting land to railroads 'to aid in construction'. . . . [A] mountain of questions remain unanswered. With legislation pending before Congress to extend still more public aid to railroads, it is especially vital that those questions be answered."[40]

The Interior Department did not pass on this petition for four and a half years. In December 1976, on the eve of a change of Administration, the Department determined that the requested investigation was not within its authority and responsibility; that study of the earnings of the railroads from grant lands was beyond its jurisdiction and expertise; and that past investigations of this kind had ordinarily been conducted by the Congress, with the single exception of the Oregon and California land grant where investigation by the Attorney General had led to Congressional enactment of a revestment statute. The Department therefore declined to undertake the investigation sought by the petitioners.[41]

During the course of the Interior Department's consideration of this matter, several Senators and Representatives had jointly written to Secretary Morton calling attention to the petition and requesting extensive information "to assist us in determining Congress's responsibilities with regard to land granted railroads".[42] The Department also received requests from private citizens "to investigate possible abuses of the land grants, principally with respect to the land management practices of the Southern Pacific and other western based land grant railroads".[43]

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[40] Petitioners' Response to Reply Brief of Southern Pacific Transportation Company and Southern Pacific Land Company, U.S. Department of the Interior, October 20, 1972.

[41] Legal Analysis of Administrative Complaint filed with the Department of the Interior by the Coalition for Land Reform and the California Coalition of Seasonal and Migrant Farm Workers, Relative to the Federal Railroad Land Grants 1850 to 1871, Concurrence by Acting Secretary of the Interior, December 23, 1976.

The finding that "the Secretary of the Interior has no general authority or duty to investigate the status of the land grants that were made to certain railroad companies during the 19th century, nor does he have any general authority or duty to investigate the activities of the railroads in connection with such grants" made it unnecessary for the Department to evaluate the merits of the allegations made in the petition concerning abuses of the railroad land grants or of the proposed remedies. Presumably, however, Congress itself could conduct such an investigation or request the Attorney General to do so.

Probably the most important policy questions involving the railroad land grant issue which have become the focus of active Government concern in recent years are those relating to 1) the rate concessions to which the Government was entitled under the original terms of the grants, and 2) the transfer of unsold railroad land grants and reserved mineral rights from the railroads themselves to affiliated non-railroad companies. These questions are examined in succeeding chapters of this report.

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[42] Letter August 30, 1972 to Honorable Rogers C.B. Morton, signed by Representatives Robert W. Kastenmeier (Wis.), James Abourezk (S. Dak.), Philip Burton (Calif.), Ronald V. Dellums (Calif.), Bob Eckhardt (Tex.), Don Edwards (Calif.), Paul N. McCloskey, Jr. (Calif.), William F. Ryan (Calif.), John F. Seiberling (Ohio), Jerome R. Waldie (Calif.); and Senators Fred R. Harris (Okla.), Edward M. Kennedy (Mass.), and Gaylord Nelson (Wis.). Aside from the legal analysis prepared in support of the Department's decision not to investigate, little of the requested information was supplied.

[43] Letter June 14, 1974 to Senator Lee Metcalf (Mont.) from Acting Solicitor, U.S. Department of the Interior.

III

Railroad Land Grant Rate Concessions

The railroads have argued that the grants of land they received from the public domain should not be counted in any comparison of Federal aids to the various modes of transportation because the Government was repaid for these lands through rate concessions required by the terms of the land grant statutes on Government traffic carried by the railroads. Analysis shows that this argument is based on incomplete reasoning and avoidance of relevant facts.

Most of the railroad land grants contained provisions under which the Government was to be entitled, without time limitation, to rate concessions for the movement of Government freight and passenger traffic over the lines built with the aid of the grants.[44] These provisions took a variety of forms, the most common of which, following the pattern established in 1850 with the Illinois Central grant, required that the railroad receiving the grant "shall be, and remain, a public highway for the use of the government of the United States free from all toll or other charge, for the transportation of any property or troops of the United States".[45] Other land grants provided that the aided railroads were to carry Government property and troops "without any charge" or at such rates as Congress might establish.

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[44] One of the exceptions to this general policy was the Union Pacific land grant in 1862 where no rate concession was required.

[45] 9 Stat. 466 (1850).

Disputes arose early between the Government and the railroads as to the meaning of the "free from all toll or other charge" clause, the railroads arguing in general that the right of the Government to free transportation applied only to the use of the right-of-way and not of railroad equipment and other facilities. A Supreme Court decision upheld by a 5-4 vote the view that the Congress must have intended such a distinction and that the carriers were entitled to compensation for the use of rolling stock and other transportation expenses in the movement of Government traffic.[46] The Court of Claims later fixed 50 percent of the regular commercial rate as the proper rate to be paid by the Government under the Supreme Court formula.[47]

For the sake of parity of treatment, Congress provided in a series of subsequent enactments that, with minor exceptions, a standard reduction of 50 percent of the commercial rate was to be applicable on most of the land-grant mileage on which the railroads were required to haul Government freight and troops at less than commercial rates. With respect to a negligible amount of mileage Government traffic was still to be hauled free. The reductions applied to a total of 14,265 miles—the 50 percent reduction on 13,340 miles and the free provision on the remainder.[48] (Table 2) It will be recalled that the routes receiving land-grant aid totaled about 18,000 miles. By comparison, it may be noted that the aggregate roadway of all line-haul railroads in the United States was about 250,000 miles at the turn of the century and about 225,000 miles in 1946.

In order to compete for Government traffic with the rail routes on which such rate concessions applied, other railroads offering rival routes individually or jointly met the land-grant

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[46] Lake Superior & Mississippi Railroad vs. United States, 93 U.S. 442 (1876).

[47] Atchison, Topeka and Santa Fe Railroad Company vs. United States, 15 Court of Claims 126.

[48] Norris Kenny, "The Transportation of Government Property Over Land-Grant Railroads", in Journal of Land and Public Utility Economics, November 1933, p. 377.

TABLE 2

Mileages of Land-Grant Railroads to Which Rate Concessions Applied

RAILROAD	STATE	MILEAGE	PERCENTAGE OF FULL RATE PAID BY GOVERNMENT
Atchison, Topeka & Santa Fe	Kansas, New Mexico, Arizona, California	1,367.38	50%
Atlantic Coast Line			
Louisville & Nashville	Alabama, Florida	507.00	50
Nashville, Chattanooga & St. Louis	Alabama	20.00	50
Canadian National			
Grand Trunk Western	Michigan	60.00	50
Canadian Pacific			
Duluth, South Shore & Atlantic	Michigan	63.00	50
Minneapolis, St. Paul & Sault Ste. Marie	Wisconsin	257.00	50
Chesapeake & Ohio			
Pere Marquette	Michigan	170.66	50
Chicago & North Western	Iowa, Minnesota, Michigan, Wisconsin, South Dakota	838.62	50
Chicago, St. Paul, Minneapolis & Omaha	Wisconsin, Minnesota, Iowa	657.97	50
Chicago, Burlington & Quincy	Iowa, Missouri	486.38	50
Chicago, Milwaukee, St. Paul & Pacific	Minnesota, Iowa, Michigan	380.38	50
	Minnesota	481.47	Free
Chicago, Rock Island & Pacific	Iowa, Arkansas	448.75	50
Great Northern	Minnesota	599.71	50
Illinois Central	Illinois, Iowa	1,034.31	50
Central of Georgia	Alabama	84.00	50
Gulf & Ship Island	Mississippi	40.00	50
Yazoo & Mississippi Valley (Alabama & Vicksburg—96 miles in Mississippi) (Vicksburg, Shreveport & Pacific — 170 miles in Louisiana)	Mississippi, Louisiana	266.00	50
Missouri-Kansas-Texas	Kansas	125.77	Free
Missouri-Kansas-Texas of Texas. (Line leased from Vicksburg, Shreveport & Pacific)	Louisiana	20.00	50
Missouri Pacific (St. Louis, Iron Mountain & Southern—599.66 miles in Missouri and Arkansas)	Missouri, Arkansas	596.66	50
New York Central	Michigan	60.00	Free
Michigan Central	Michigan	259.74	Free
Northern Pacific	Wisconsin, Minnesota, North Dakota, Montana, Idaho, Washington, Oregon	2,362.46	50
Pennsylvania			
Grand Rapids & Indiana	Michigan	278.00	50
St. Louis-San Francisco	Missouri	291.30	50
Seaboard Air Line	Florida	521.00	50
Southern	Alabama	145.00	50
Alabama Great Southern	Alabama	244.94	50
Mobile & Ohio	Mississippi, Alabama	333.28	50
Southern Pacific	California, Oregon	1,264.77	50
Total		**14,265.55**	

SOURCE: *Kenny, op. cit., p. 377.*

rates through "equalization" rate agreements with the Government; after 1914, these agreements were entered into with the railroads collectively. As a result of such industrywide rate equalization, which was voluntary on the part of the railroads not required to furnish land-grant rate reductions, Government freight and troops moved over all routes of the railroad system at uniform competitive rates.[49]

As noted earlier, huge as the Federal land grants to railroads were, only a small percentage of the total railroad mileage of the country was built with the aid of such grants. It is not surprising, therefore, that the Government derived a greater saving from the concessions voluntarily made by the rate-equalizing railroads than from the statutory land-grant rate concessions.[50]

In 1940, as part of the omnibus Transportation Act of that year, Congress repealed the requirement of land-grant rail rate reductions on the movement of mail and "civil" property of the Government. The rate concessions were maintained, however, for transport of troops and of military freight. As a condition of the Government's partially giving up the right to statutory rate concessions on land-grant routes—and the corresponding voluntary concessions received under equalizing rates on non-land-grant routes—the 1940 Act required that the land-grant railroads release any claims upon such portions of their grants as, for one reason or another, still remained unpatented despite the lapse of 70 years or more from the time of the initial grants. A total of 8.3 million acres of claims to unpatented land were cancelled under this provision.[51]

In 1946, under an Act passed by Congress the year before, the remaining right to land-grant rate concessions of the Government on movement of military property came to an end; the railroads were not required to give up anything in exchange for this final surrender of the Government's right to these concessions.[52]

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[49] Federal Coordinator of Transportation, *op. cit.*, p. 42.

[50] David M. Ellis, "Railroad Land Grant Rates, 1850-1945", in Journal of Land and Public Utility Economics, August, 1945, p. 213.

[51] U.S. Senate, Committee on Public Lands and Surveys, S. Report No. 404, 75th Congress 1st Session, 1943, p. 20.

The argument of the railroad industry that the value of the land-grant rate concessions made by railroads to the Government exceeded the value of the land grants received by the railroads from the government is fallacious for the following reasons:

1. It understates the value of the granted lands to the railroads in comparison with the value of the rate concessions made by the railroads.
2. It fails to distinguish between the rate concessions which the railroads receiving land grants were required to provide on Government traffic and the equalizing rate concessions made voluntarily and for profit reasons by non-land-grant railroads.
3. It ignores the policy of the Interstate Commerce Commission in regulating rates to compensate for reduced rate levels on Government traffic by means of higher rate levels on other traffic.
4. It makes no allowance for the availability of rate reductions for Government traffic under Section 22 of the Interstate Commerce Act even in the absence of land-grant rate reductions.
5. It fails to take account of the fact that because of the excess profits tax in effect during World War II, when the bulk of the land-grant rate concessions were made, railroad revenue reductions attributable to the rate concessions were not matched by reductions of after-tax railroad income.
6. It omits from the value comparison any allowance for the long time interval between the 1850-71 period, when the grants of Government lands to the railroads were made, and the World War II period, when the bulk of the rate concessions were received by the Government.

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[52] 54 Stat. 954 (1945).

7. It overlooks the fact that the Government had an unqualified contractual right to receive the benefit of the land-grant rate concessions in perpetuity.

8. It neglects to mention that even Government officials who recommended final repeal of the land-grant rates recommended also that, as a matter of equity to the Government, such repeal should be accompanied by a return to the Government of such of the granted lands other than right of way as were still in the hands of the railroads.

Value of Lands

The basic position of the railroad industry with respect to the value of the lands received under the land grant program was initially put forth in connection with its successful campaign to persuade Congress to repeal the rate concessions which required under the terms of the land grants. The essence of that position was that "the value of the lands granted to the railroads was not more than the top price at which the Government was offering to sell the land—for the most part without success—in the states where the land grants were made".[53]

This approach was later quantified by an AAR official as follows: "During the period in which the land grants were being made to the railroads, the average sales price of government lands in the land-grant states was less than $1 an acre. Applying that price to the lands granted to the railroads gives a value as of the time of the grants, of less than $130,000,000."[54] This figure relates only to Federal lands granted. Adding a similar allowance for the 49 million acres of land grants received by the railroads for state-owned lands would bring the total to roughly $180 million.

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[53] Statement submitted by R.V. Fletcher, general counsel, Association of American Railroads, Hearings before the House Committee on Interstate and Foreign Commerce on H.R. 10620, "Eliminating Land-Grant Reductions in Compensation for Transportation", 75th Congress, 3rd Session, May 31, 1938.

[54] R.S. Henry, "The Railroad Land Grant Legend in American History Texts", in Carstensen, *op. cit.*, p. 131.

The price at which the Government was selling land is, of course, an inaccurate reflection of the benefits received by the railroads from their extensive grants. As students of American economic history are well aware, "there seems little question that what the railroads were primarily interested in was the potential value of the grants. In fact, they confidently and as it turned out, correctly, expected to realize a sum far in excess of that current value of back-country lands."[55]

> "[I]t was the potential value of the lands which made the grants attractive to the railroads. . . . The immediate objective . . . was to provide the railroads with a basis for financing construction of their lines, by enabling the carriers to raise funds currently from direct sales, or to obtain credit on the basis of the enhanced values that the lands were expected to acquire. . . . Potential worth of the lands was the essence of the land-grant transactions. The Federal and State governments conveyed nearly 10 percent of the total land area of the continental United States. No other disposition of public lands in the United States on a comparable basis has occurred. . . . It seems clear that both the government and the railroads were thinking in terms of the potential worth of the lands and not merely of their value prior to the grants and the building of the railroads."[56]

As was intended, the potential value of the land grants was a vital factor in attracting the substantial amounts of railroad capital needed to finance construction of the lines.

Although precise data on the early land transactions of the railroads receiving these grants are not available, there is no doubt that the railroads were able to sell off large acreages at prices far greater than those at which the Government had previously disposed of public lands.[57] Based on data concerning proceeds of railroad sales of lands derived from Federal and State land grants "to the extent they have been reported", the Federal Coordinator of Transportation estimated in 1938 that the railroads had netted, after expenses, about $440 million from such sales.[58] However, a significant portion of even those sales were made to companies affiliated with the railroads and there is no way of tracing the ultimate resale price of those lands or the substantial profits realized by the affiliates on such resales.

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[55] David M. Ellis, "Comments on 'The Railroad Grant Legend in American History Tests' " in Carstensen, *op. cit.*, p. 148.

[56] Board of Investigation and Research, *op. cit.*, p. 113.

[57] Ellis, "Comment", *op. cit.*, p. 148.

As pointed out by the Federal Coordinator of Transportation in referring to the situation involving the Southern Pacific: "[A]vailable data indicate that the eventual profits to the common parent company, and some of its tockholders, from the disposal of certain of the lands by the affiliate were large, but do not enable determination of the amount of such profits. . . . If the profits . . . from the operations of these subsidiaries in connection with the grant lands sold to the subsidiaries could be determined, they would largely increase the total net proceeds of all railroads from the disposal of grant lands."[59]

Far overshadowing the benefits of the land grants to the railroads in attracting capital and producing an impressive flow of cash from land sales is the current value of the grant lands and mineral rights still retained by the railroads at the present time. These include some of the richest mineral (oil, coal, uranium, trona), timber, and agricultural lands in the nation.

In the comprehensive report on "Aids to Railroads and Related Subjects" in 1938, the Federal Coordinator of Transportation recognized the importance of including in the estimated value of the land grants to the railroads the value of unsold lands and reserved rights still held by them. Based on an estimate supplied by the Interstate Commerce Commission, the report used a figure of $50 million as the value at that time.[60]

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[58] Federal Coordinator, *op. cit.*, p. 38.

[59] Ibid., p. 39-40.

[60] Ibid., p. 48.

Whatever the basis of the information relied upon in 1938, that figure has no relevance to present values. The annual income which is today generated by these lands, chiefly from resource and real-estate development, is alone far in excess of the total property value assumed earlier. Available current information concerning these holdings and the income they produce is summarized in Part IV of this report.

Equalization

It is essential to understand that under the land-grant statutes, rate reductions were required only on Government traffic moving on the railroads that received land grants. Moreover, these reductions applied only on certain lines of those roads. Table 2 lists the railroads and the mileages to which the land-grant rate reductions applied. Out of about 18,000 miles of total land-grant rail routes, rate reductions were furnished only on some 14,000 miles. Chief among the land-grant railroads not required to carry any Government traffic at reduced rates was the Union Pacific; on other land-grant roads which included some rate-reduction mileage, significant routes were free of the rate-reduction requirement.

It is also essential to understand that the mandatory rate concessions made on land-grant rate-reduction mileage were minor in comparison with the corresponding concessions made voluntarily on the rest of the nation's railroad system. As noted earlier, these latter reductions were made under equalization agreements between the Government and the railroads generally.

When Government freight was shipped by railroad, the Government was entitled to receive the statutory rate reduction on those portions of the route to which the reductions applied, and accordingly to select a routing that entailed the lowest freight cost to the Government. Where the shipment moved entirely over land-grant rate-reduction routes, the reduction applied to the rate for the whole movement. Where, as more commonly happened, a route involved the participation of both land-grant rate-reduction carriers and other carriers, the reduction was calculated only on the land-grant portion of the combined rate, not on the entire rate. Through the operation of through routes, joint rates, and rate divisions, however, the rate reductions on land-grant mileage were in part absorbed by other roads.

Carriers operating over alternate routes and wishing to participate in the Government traffic had naturally to offer competitive rates, and this was routinely done. "Because of this competitive influence, the land-grant rate is not only given by the railroad that received the land grant but by others that have equalized the rates in order to get the traffic."[61]

The mechanism employed was an "equalization" agreement, under which all of the railroads, land-grant and non-land-grant alike, undertook to handle Government traffic, no matter what the routing, at rates that matched those to which the Government would be entitled if it used the most favorable route incorporating land-grant rate-reduction mileage. The earliest equalization agreements were with individual railroads and were already employed in the 1880's. After 1914, these arrangements took the form of collective agreements with the railroads generally.

In comparing the value of land grants with that of the rate concessions, the railroad industry includes in the latter not only the mandatory rate reductions over land-grant rail mileage but all of the matching rate reductions made by other railroads for ordinary business reasons. It was undoubtedly advantageous from the Government's standpoint to have alternative, and frequently less circuitous, routings over which its freight could be shipped at the same rates as those to which it would be entitled if, in order to minimize its transportation costs, it used the most favorable route embodying land-grant rate-reduction mileage. It is also reasonable to assume that the equalizing railroads would have preferred not to reduce their rates in order to compete with land-grant rate-reduction routes for Government traffic. But it does not follow that the rate reduction made voluntarily and for competitive, profit-maximizing reasons by the railroads which received no land grants represents in any significant sense a repayment to the Government for the lands granted to other roads. At most, only the rate reductions which land-grant railroads were required to make would be relevant to the concept of repayment.

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[61] Testimony of ICC Commissioner Joseph B. Eastman in "Eliminating Land-Grant Reductions in Compensation for Transportation", Hearings before House Committee on Interstate and Foreign Commerce, on H.R. 10620, 75th Congress, 3rd Session, May 31, 1938, p. 5.

This question was incisively addressed and conclusively disposed of by the Federal Coordinator of Transportation:

> "As has been seen, the government receives rate concessions from many railroads which were given no land and are not obliged to make such concessions. They are made because these railroads wish, for profit, to share in the government traffic, even under the reduced rates. This indicates that the concessions are not, in one sense at least, a burden on the land-grant railroads. It also indicates that, even if they are a burden in another sense, it has been lifted in part by the voluntary action of competitors. There is no sound reason why this voluntary action, for the sake of profit, should be deemed to have diminished the value of the lands to the railroads which got them. The loss of revenues which the latter have actually suffered because of the obligation they assumed is all that is entitled to consideration in this connection."[62]

The fact that all railroads, whether or not they were under a land-grant obligation to carry Government traffic at reduced rates, nevertheless equalized their rates so that the freight cost to the Government was the same whether the traffic was routed over land-grant routes or over competitive routes is a clear indication that the rates were profitable. During the 1938 hearings on repeal of the land-grant rate concessions, a Treasury Department official testified on this point as follows:

> "Mr. Holmes: Do you believe that the railroads can handle those shipments at a profit that would justify that discount or cheaper rate?

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[62] Federal Coordinator, *op. cit.*, p. 47.

> "Mr. Hayghe: Yes, sir; . . . that can best be demonstrated by the filing of these equalization agreements by other carriers. . . . I think that answers the question as to whether the traffic is remunerative. The non-land-grant carrier, seeking to handle government property at the land-grant rate, can at any time it sees fit, through the simple expedient of canceling the equalization agreement, relieve itself."[63]

While available data do not permit an exact separation between the rate concessions made on the land-grant railroads required to make them and the matching concessions made on other routes and roads, there is no question that, of the estimated $1 billion total of concessions made by all of the railroads, those which the land-grant roads were obliged to make represented only a minor portion. As noted earlier, the total railroad mileage built with land grants was less than 8 percent of the total railroad network, and not all of the land-grant mileage was subject to the rate-reduction obligation.

In the 1938 hearings on repeal of the land-grant rate concessions, one official testified that an investigation showed that the land-grant carriers bore about 45 percent of the total rate reductions received by the Government. It is not clear whether this figure includes the land-grant railroads, such as the Union Pacific, and portions of the routes of other land-grant carriers, on which no rate reductions were required but which were included under the equalization agreements. The estimate appears generous in relation to the limited total rail mileage on which land-grant rate reductions were mandatory.

Perhaps the best summation on this point was made by the chairman of the Board of Investigation and Research in Congressional testimony: "[I]t can safely be said that required land-grant reductions have accounted for a considerably smaller part of the total savings than have voluntary equalization concessions by competing lines. . . ."[64]

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[63] Hearings on "Eliminating Land-Grant Reductions in Compensation for Transportation", *op. cit.*, p. 21-22.

Recoupment from Shippers

In their campaign for repeal of the land-grant rate reductions, the railroads repeatedly argued—and the argument was echoed by supporters of repeal—that the rate concessions to the Government were necessarily reflected in higher rates to other shippers so that repeal of the concessions would result in holding down the rates charged the public generally.

Thus, H. A. Scandrett of the Milwaukee Railroad testified: "Now necessarily if a substantial part of that traffic is to take the lower rate, you have to have an aggregate whole that will be sufficient to maintain these railroads, and, therefore, the traffic that has not the benefit of the lower rates inevitably, in the process of time, pays a higher rate than would otherwise be necessary."[65] This theme, that reduced Government rates were matched by higher rates to the general public, was emphasized in the colloquy that followed:

> "Mr. Boren: And in any period of rate adjustments, then, that affects the individual shipper out through the country, the rate that he pays at any time when railroad rate adjustments are up before the Commission is affected to exactly the same extent that the government is treated as a special shipper and receives benefits."
>
> "Mr. Scandrett: That is true."[66]

An Association of American Railroads official, R. V. Fletcher affirmed that abolition of the land-grant rates would be reflected in a reduction of rail rates generally:

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[64] "Report of Land-Grant Rates on Transportation of Government Traffic", Hearings before the Senate Committee on Interstate and Foreign Commerce, H.R. 4184, 78th Congress, 2nd Session, August 18, 1944, p. 168.

[65] "Repeal of Land-Grant Rates on Transportation of Government Traffic", Hearings on H.R. 4184 before the House Committee on Interstate and Foreign Commerce, 78th Congress, 2nd Session, March 16, 1944, p. 101.

[66] Ibid., p. 102.

> "The Interstate Commerce Commission makes the rates for the railroads . . . with some reference at least to the needs of the railroads for revenue. If the need of the railroads for revenue is not so great after the land-grant rates are repealed and they are furnished with this additional revenue, the tendency would be, of course, to a downward revision of the general rates."[67]

The Commission itself, in endorsing repeal, expressed a similar view through the testimony of Commissioner Mahaffie:

> "Mr. Youngdahl. What effect, in your opinion, would the elimination of land-grant rates have upon the shippers?
>
> Commissioner Mahaffie. The shippers I think would benefit primarily in this respect, and this is the thing that I attempted to stress in my statement—that the shippers have to support this railroad system. If the Government is shipping a large amount of freight at a cut rate, the requirements on the other shippers are to that extent increased. If you assume, we will say, that this Government traffic represented a reduction in railroad revenue of $100,000,000, you have got to have rates that other shippers pay to make it up, because your transportation system has to be supported.
>
> Mr. Youngdahl. Then, in the event land-grant rates were eliminated, would the shippers receive benefits in the nature of reduced rates?
>
> Commissioner Mahaffie. Perhaps not immediately, but the eventual result, I think clearly would be in favor of the shippers."[68]

In a subsequent hearing in the Senate, this view of the Commission was reinforced:

> "Senator Shipstead. I have had letters from people who pay the bills and several of them take the position that

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[67] Ibid., p. 61.

[68] "Repeal of Land-Grant Rates on Transportation of Government Traffic", Hearings on H.R. 6156 before the House Committee on Interstate and Foreign Commerce, 77th Congress, 2nd Session, February 19, 1942.

> the rates now and for a long time fixed by the Interstate Commerce Commission have been so fixed that the general public, the shippers, have had to pay rates to counterbalance the loss of revenue to railroads because of these land-grant rates. Is there anything in that contention?
>
> "Commissioner Mahaffie. That is abolutely correct.
>
> "Senator Shipstead. If I understand the situation correctly, the public has made up in increased rates what the railroads have lost by this arrangement. Do I understand that correctly?
>
> "Commissioner Mahaffie. Speaking generally and over the long run, that is true. Shippers who pay the rates must support the railroad system. Some shippers getting their service at a reduction would mean others have to pay that much more to support the railroads.
>
> "Senator Shipstead. Then the railroads have not lost income because of these rates.
>
> "Commissioner Mahaffie. I think probably that would follow."'[69]

The logical implications of this line of argument dictate the conclusion that the land-grant rate concessions, no matter how they are figured, were primarily a burden on the general shipping public from which they were recouped rather than on the railroads.

In the final Congressional debate on the repeal legislation, the point was vigorously made that the termination of the land-grant rates would not result in increased income to the railroads but in reduced rates to shippers generally. Congressman Harless of Arizona, in summarizing the case for repeal, stated: "[I]f there is any increased income it will be given to the shippers and ultimately to the consumers. There will be a readjustment in rates."[70] Again, it follows that if the result of repeal of the land-grant rate concessions was a reduction in rates paid by commercial shippers, the burden of those concessions prior to their repeal must have been borne largely by those shippers.

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[69] "Repeal of Land-Grant Rates on Transportation of Government Traffic", Hearings on H.R. 4184 before a Subcommittee of the Senate Committee on Interstate and Foreign Commerce, 78th Congress, 2nd Session, June 8, 1944, p. 9-10.

[70] Congressional Record, May 4, 1945, p. 41-90.

Section 22 Rates

In appraising the true significance of rate concessions required of the land-grant railroads under the land-grant statutes and voluntarily made by other railroads under the equalizing agreements, it is pertinent to note that, even in the absence of those concessions, it is highly likely that rate reductions would have been provided on Government traffic under Section 22 of the Interstate Commerce Act.

That section, which had been in the Act since its passage in 1887, permitted carriers to enter into negotiated agreements with the Government to move property and personnel at rates lower than offered to the general public without violating the provisions of the Act prohibiting unjust discrimination or preference. Rate reductions under Section 22 were commonplace for a long time and were extensively employed during the World War II period. Following the repeal of the land-grant rate concessions, Section 22 rate reductions applied to considerable volumes of Government traffic and undoubtedly would have been invoked to a greater extent in the years prior to 1946 if land-grant rates were not available. Under Section 22 preferential rates, of course, rate reductions on Government traffic were made applicable uniformly on all railroads without going through the roundabout device of "equalization" as was necessary under the land-grant rates.[71]

It is pointless to speculate on the extent to which Section 22 rate reductions would have been employed in the absence of the land-grant rates, but it is a relevant footnote to the land-grant story to observe that the availability of rate concessions to the Government was not associated exclusively with provisions arising from the land grants.

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[71] Section 22 rates were largely repealed by the Railroad Revitalization and Regulatory Reform Act of 1976, P.L. 94-210.

Excess Profits Tax

As shown earlier, about 85 percent of the total rate concessions of the railroads while the land-grant rates were in effect occurred during the period of heavy wartime traffic. Steep excess profits taxes were in effect during most of this period, so that any loss of income that may be presumed to have resulted from the rate concessions were, in the actual circumstances, to a large extent offset by the increased tax liabilities the railroads would have incurred had such concessions been absent.

During the controversy over repeal of the land-grant rates, the railroads cited the applicability of the near-confiscatory excess profits tax rate to argue that any revenue increase resulting from such repeal would mean little increase in after-tax income for the railroads.

A trustee of the Milwaukee testified:

> "In the case of the Milwaukee Road, and this I believe is true of most of the railroads, an excess-profit tax carry-over credit is exhausted and the total increase in gross revenues incident to repeal of the land-grant acts will be subject to the excess profits tax of 95 percent, with a post-war credit of 10 percent, or a net tax of 85 1/2 percent."[72]

If the absence of land-grant rate concessions during the high-tax war years would have had limited impact on the flow of railroad after-tax income, it must equally be true that the presence of such concessions during those years must have had correspondingly limited effect on after-tax income.

Time Interval

In any valid comparison of the value of the land grants received by the railroads with the value of the rate concessions made by the railroads, the vast difference in the times at which the grants and the concessions occurred must be given proper weight. All of the grants were made between 1850 and 1871, and as they were used almost immediately for the purpose of raising capital the financial benefits accruing to the railroads may fairly be said to run from that period.

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[72] "Repeal of Land-Grant Rates on Transportation of Government Traffic", Hearings on H.R. 4184, 78th Congress, 2nd Session, March 16, 1944, p. 70.

The total amount of Government rate reductions associated with the land grant provisions has been estimated at about $1 billion. Roughly 85 percent of these reductions are attributable to the World War II period. In the first fifty or more years that the rate concessions were in effect, they represented an average annual revenue difference of less than $1 million; through 1927, the total is estimated at about $55 million. In the 1928-1940 period, the rail revenue difference between the rate charged the Government and the rates charged commercial customers, averaged less than $7 million a year, totaling about $85 million. The balance of about $860 million, averaging about $145 million a year, was concentrated in the war period between 1941 and September 30, 1946, the date at which the land-grant rate concessions were terminated.

As pointed out in a 1977 report of the Secretary of Transportation to Congress, "any comparison of the respective estimates of rate reductions and land grant values must recognize that the costs and benefits derived from them were concentrated at opposite ends of a 90 year continuum".[73]

There is no scientific or precise way of allowing for that time difference, but this difficulty should not be permitted to obscure the plain significance of the difference, namely that under even the most conservative assumptions the value of the land grants far outweighed the value of the rate concessions. For example, let us, for the purpose of such a calculation only, make the following assumptions:

1. That the total value of the land grants to the railroads

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[73] U.S. Department of Transportation, "Study of Federal Aid to Transportation", Report of the Secretary of Transportation to the United States Congress pursuant to Section 902 of the Railroad Revitalization and Regulatory Reform Act of 1976, Washington, D.C., January, 1977, p. III-10.

was $177 million, representing the net amount of 177 million acres of Federal and State lands received by the railroads valued at $1 an acre, the price at which public lands were sold prior to the grants. This ignores entirely the much higher sales prices actually realized by the railroads, the profits made on resales by affiliates, and the current value of the grant-lands still held by the railroads or their affiliated companies.

2. That the total value of the rate concessions was $1 billion, representing not only the rate reductions required of land-grant railroads which were the minor portion of the total, but also the much larger "equalizing" reductions offered for competitive and profit-seeking reasons by non-land-grant railroads. This assumption ignores, as well, the voluntary nature of the equalizing reductions and the clear indication that the rates involved were profitable; the fact that lower rates on Government traffic were offset by higher rates on other traffic; the likelihood that in the absence of land grant rates the Government would have received rate reductions under Section 22 of the Interstate Commerce Act; and the fact that most of the alleged loss of railroad revenue occurred in the World War II period when the operation of excess profits taxes greatly diminished the real after-tax significance of the difference between land-grant rates and normal commercial rates on Government traffic.

ICC Commissioner Joseph B. Eastman, who served also as Federal Coordinator of Transportation, commented directly on the time-interval question in Congressional testimony:

> "Mr. Pettengell. The amount the government has received back by way of rate reductions, or freight-rate reductions, troop movements, and so forth, has been in excess of the value of the land at the time it was given to them?
>
> "Mr. Eastman. Yes, I do not think myself that that statement means much, because, of course, the railroads have had the use of this land and of the money which is produced, and they were saving interest on money which they would have had to get out of investors otherwise. Of

course, that must be taken into consideration. . . ."[74]

In order to make a meaningful comparison between the value of the land grants and the value of the rate concessions it is necessary to make the two values comparable. The established method of adjusting for timing differences of this kind is by means of an interest factor.

Debt capital was relatively expensive during the nineteenth century when it was needed for railroad construction. In his study of "Transcontinental Railway Strategy, 1869-1893", Grodinsky states:

> "In the post-Civil War era the limited supply of funds was actively bid for by numerous groups engaged in the creative task of building up a strong productive capacity in a rapidly growing economy. Farmers in Nebraska and Kansas paid between 10 and 15 percent for mortgage money. In Illinois and Iowa the rates were somewhat lower, averaging between 8 and 10 percent, while in the Dakota territory, loans, including substantial commission charges, averaged from 17 to 18 percent. The railroads also competed for funds with rapidly growing cities in need of municipal improvements. Other demands upon the limited capital supply came from industries: coal, iron, steel, lumber, farm equipment, copper, and an increasing variety of manufacturing and fabricating enterprises.
>
> High interest rates reflected both strong demands and high risks. Relatively little institutional money—money raised from the savings of the masses—was available for western railroad investment. Even seasoned, hard-bitten capitalists hesitated to commit their funds to western railroads. That this skepticism was justified was shown by the extensive defaults of railroad bonds in the middle and late 1870's."[75]

This shortage and high cost of capital affected all the transcontinental routes. A list of contemporary railroad bond issues in that study shows an average annual interest rate of about 10 percent, with the bonds typically priced at a substantial discount so that the effective yield was well above that rate.[76]

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[74] "Eliminating Land-Grant Reductions in Compensation for Transportation", *op. cit.*, p. 4.

[75] Julius Grodinsky, "Transcontinental Railway Strategy, 1869-1893: A Study of Businessmen", University of Pennsylvania Press, 1962. p. 10.

Interest rates fluctuated considerably in ensuing years over the entire period between the Civil War and World War II. In using an average interest rate over that period for an analogous purpose, the Federal Coordinator of Transportation concluded that "the assumption that the railroads could have secured the capital on a 5-percent basis is too favorable", and used instead an average interest rate of 8.75 percent.[77] For the purpose of the present analysis it would appear quite conservative to use two alternative interest rates, 5% and 6%.

To place the values of the land grants and the rate concessions on a comparable basis, and to insure conservative results, we apply the following procedure: 1) take the minimum value of the land grants, $177 million, which reflects only the $1 per acre price at which the Government was selling public land before the 1850-1871 period in which the land grants were given to the railroads, and also reflects only the lands actually kept by the railroads exclusive of all forfeitures, revocations, and revestments; 2) assume that none of that value accrued to the railroads until 1871, when the land-grant program ended, although the lands were in fact used by the railroads to raise substantial capital funds for construction almost as soon as the land grants were enacted; 3) determine the value in 1946, when the rate concessions ended, of the initial value of the land grants at a compound interest rate of 5 and 6 percent a year; 4) take the maximum value of the rate concessions, $1 billion, which overstates the actual rate reductions actually made by the railroads receiving the land grants; 5) compute the annual average of these concessions in the three periods for which the breakdown is available, 1871-1927, ($1 million), 1928-1940 ($7 million) and 1941-1946 ($145 million;

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[76] **Ibid., p. 11.**

[77] **Federal Coordinator of Transportation *op. cit.*, p. 47-48.**

6) determine the value in 1946 of those rate concessions at the same compound interest rate of 5 and 6 percent a year.

The higher the interest rate employed in this comparison, the greater is the value of the land grants in relation to the value of the rate concessions.

Using an interest rate of 5 percent, the 1946 value of the land grants comes to $7.0 billion, as compared with a 1946 value of $1.9 billion for the rate concessions.

Using an interest rate of 6 percent, the 1946 value of the land grants was $14.0 billion, as against a 1946 value of $2.4 billion for the rate concessions.

In an actuarial analysis of this kind, it is the relationship of the two values, not the dollar amounts themselves, that is significant. Once the values have been made comparable at a common point in time, 1946 in this case, the relationships remain constant for subsequent years regardless of the interest rate applicable to those years.

Although there is no valid basis for using an average interest rate any lower than 5 percent over the 1871-1946 period, the results under a 4 percent rate have also been calculated to satisfy any reader curiosity on this point: the results would be 1946 values of $3.4 billion for the land grants versus $1.5 billion for the rate concessions.

The baselessness of the argument of the railroad industry that land-grant rate reductions more than counterbalanced the financial benefits conferred by the land grants is all the more apparent when it is recalled that the assumptions on which the foregoing calculations are made grossly understate the value of the land grants (e.g., by omitting any proceeds from actual sales of the lands above $1 an acre and any allowance for the current value of lands still held), and grossly overstate the value of the rate concessions (e.g., by including the rate reductions made voluntarily and for profit-seeking reasons by railroads not subject to the obligatory land-grant rate reductions and by ignoring the railroads' recoupment from commercial shippers of the rate concessions made to government).

Contractual Obligation

One of the most important aspects of the controversy over repeal of the land-grant rates on Government traffic was the contractual origin of the obligation which had been assumed by the railroads at the time they petitioned for, and received, vast areas of the public domain. There was no time limit placed on the duration of the rate concessions the grant-aided railroads agreed to provide. In essence, the Government and the railroads made a bargain under which the Government granted the lands and the railroads agreed to live up to the terms of the grants, one of which was to carry Government traffic free or at reduced rates over the railroad lines built with the aid of the grants—as well as with financial and other aids—and to do so in perpetuity.

As has been shown in this report, the argument that the land-grant rate concessions fully compensated the Government for the 177 million acres of public lands granted the railroads cannot stand close scrutiny. But even if the argument were correct it could not of itself justify a surrender by the Government of its right to these concessions because there was nothing in the understandings entered into between the Government and the beneficiary railroads that called for such a termination of the Government's rights. Other arguments put forth in support of the drive for repeal can properly be regarded as having had more merit. But the unilateral waiver of the Government's entitlement to rate concessions which had been promised to the Government at the time the railroads were pressing for great grants of public lands clearly caused many members of Congress serious concern. Representative Colmer of Mississippi stated on the House floor:

> "I cannot get enthusiastic about this legislation in view of the fact that there was a contractual relationship that was entered into between the government . . . and the railroads . . . by which the government agreed to convey a vast empire of lands to the railroads, and the railroads were in turn to grant the government the right of transportation

> over those roads as was generally understood then free of charge."[78]

Representative South of Texas expressed his concern more vigorously:

> "The railroads are retaining all of their benefits, including valuable oil lands now held by some of them. But the government is not to get back even the lands now held by them. . . .
>
> "Mr. Chairman, suppose the railroads had made a bad bargain, which I contend they did not do, would it follow that the Congress ought to undertake to make it up in the form of a direct gift, or subsidy? Suppose the railroads had made a good bargain, which I think they did, would they have come in years later and handed the government a gift? Certainly not."[79]

Representative Hobbs of Alabama was even more outspoken:

> "Mr. Chairman, if this were a law case, the proponents would not have a leg to stand on. This they admit, but attempt to justify the bill because of what they are pleased to call equity. Cardinal maxims of equity, however, enjoin that he who seeks equity must do equity, and must come into equity only with clean hands. The railroads that are back of this bill, which, for the second time in 2 years, asks us to approve their welshing on their contract with the Government, come with their hands behind them, and in those hands are 20,000,000 acres of land. This land is the residue of 130,000,000 acres they admit receiving from the Government as full payment for the land-grant rate reduction in favor of the Government. Oh, but they say the lands deeded us were worth only 97 cents an acre when the deeds were made. The answer is simple and easy. No such appraisal nor consideration was recited in the deeds. The consideration was not cash, but a perpetual guaranty of reduced railroad rates to the Government. Hence the value of the lands was their real value, including timber,

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[78] Congressional Record, 77th Congress, 2nd Session, April 29, 1942, p. 3788.

[79] Congressional Record, April 29, 1942, p. 3795.

oil, and many other minerals, the value of which was proven by sales of part of this acreage for more than $500,000,000 at least, and probably three times that sum. Therefore, they do not come here with clean hands when they make no offer to do equity by surrendering the fruits of their contract, which they still have and could give back to the Government."[80]

Return of Lands

Widespread uneasiness concerning the equitableness of the proposed repeal of land-grant rates from the standpoint of the public interest led many participants in the controversy, including some who felt there were sound public reasons for supporting repeal, to endorse the proposition that the surrender of land-grant rate concessions to which the Government was entitled under the land-grant statutes should be accompanied by a return to the Government of unsold grant lands still held by the railroads and being used for other-than-railroad purposes.

Representative Colmer proposed an amendment the gist of which was "that if the railroads want to abrogate the contracts they entered into, they shall in turn convey to the Government whatever lands they have left—that is a fair proposition—lands they have not disposed of."[81]

Representative Everett Dirksen of Illinois supported this proposal, stating:

> "Now an agency of the Government known as the Congress proposes to take the initiative in rescinding this contract—rescinding it with the railroads on the other end of the contract in entire agreement. That may be entirely all right, but I confess to you very frankly that I do not propose to vote to rescind that kind of a contract until some type of equitable procedure is applied so that the lands which the railroads now hold may be reconveyed to the Federal Government.

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[80] Ibid., p. 3800.

[81] Ibid., p. 3793.

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> "As gentlemen have pointed out, much of this land is underlaid with petroleum. Some of the finest timber stands, as related before the Committee on Agriculture, dot a great deal of this land. Certainly those natural resources are not there as a result of any activity or endeavor on the part of the railroads. Is it not fair, then, that we put the Federal Government in a proper position by insisting that the 14,000,000 or more acres of land that still seem to be outstanding and that are not used in the normal operation of the railroads be returned to the Federal Government?
>
> "How much is involved? There is not a scintilla of evidence to show how much oil, how much timber, how much gold, how much coal, how much natural resources or how much other wealth that was never created by the railroads may be involved. For aught I know, and I am just guessing, there may be $1,000,000,000 or more involved here."[82]

Representative Leavy of Washington dealt forcefully with this issue, using for illustration the Northern Pacific, which passed through his district and was later merged into what is now the Burlington Northern system:

> "The Northern Pacific Railway Co. owns at present 5,600,000 acres of land that it got by virtue of this grant. It has heretofore disposed of millions of acres of granted lands, and has this amount of land left. The actual value of this vast expanse of land is difficult to estimate. It is a safe assertion that it is worth many millions of dollars. This is a part of the consideration given by the Government to secure the carriage of its freight and passenger business for 50 percent of the regular tariff. To relieve the railroad company of this responsibility to haul Government freight and passengers and yet permit them to keep the consideration is indefensible.
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> "The N. P. P. Co. defeated the grant originally made. The original grant by Congress was to the effect that they must sell this land granted in blocks of 160 acres to any

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[82] Congressional Record, April 29, 1942 p. 3799-3800.

> bona fide applicant for not to exceed $2.50 an acre. However, the railroad company went through a receivership and became the Northern Pacific Railway Co., whereas when the grant was made it was the Northern Pacific Railroad Co. That case went to the Supreme Court of the United States and in a 5 to 4 decision this railroad was relieved of the responsibility that existed to sell this land at not more than $2.50 per acre in tracts of 160 acres, and they refused sales of the better lands. They still hold 5,500,000 acres of grant land, spotted through the national forests and on the public domain, and some of the sections of timber contain the finest stands of white pine that grows. The timber alone is worth $75,000 on a single section in some cases. It is in the heart of the national forests, railroad company owning every other section. The Government is now affording fire protection and pest control and every sort of protection, building roads and trails, and at great public expense, generally preserving this valuable estate because they have this checkered ownership.
>
> "Why should not the Northern Pacific at least be required to convey back that consideration which they took and which they have shifted about until they have gained an undue and unconscionable advantage? Why should they not convey it back, if they ask to relieve themselves of the responsibility they assumed when they entered into this contract 80 or 90 years ago? That is all we ask here. It is not right to permit them to be relieved of all responsibility and also keep the consideration.
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> * * *
>
> "The railroads have no more right to take the property of the United States Government, agreeing to perform a certain service, and to refuse to perform and also keep the payment received. We all would condemn such conduct between individuals. It is just as wrong, and even more so, when the Government is involved. . . ." [83]

During the 1942 consideration of repeal legislation, the Department of Agriculture, interested in 4 million acres of grant lands still owned by the railroads and lying within the boundaries of national forests, urged that "reconveyance by the land-grant railroads to the United States of all grant lands still owned by the railroads, or subsidiaries thereof, would seem to be fully justified by principles of reciprocity and equity."[84]

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[83] Congressional Record, April 29, 1942, p. 3799.

Two years later, when the repeal legislation was again before the Congress, Secretary of the Interior Harold Ickes recommended that the repeal provisions should "not apply to any land-grant railroad unless or until such railroad or land-holding subsidiary has reconveyed to the United States all patented lands except those sold to third persons for value and those directly used in the operation of the railroad. If the United States surrenders a valuable right to the railroads, it should receive a proper consideration. It is in the public interest to return these lands to the public domain."[85]

In objecting to the proposed return of unsold grant lands to the Government, the railroads had argued that "such reconveyance would fall inequitably on these few railroads which still retain substantial amounts of grant lands, whereas others which have disposed of all or nearly all of their lands would sacrifice little or nothing."[86]

The Board of Investigation and Research, in its final report on "Public Aids to Domestic Transportation", strongly supported repeal of the land-grant rates, but also strongly endorsed the proposal that such repeal should be accompanied by the return of unsold grant lands to the Government. The Board did not regard the railroad objections as meritorious:

> "As a condition to the repeal of land-grant rates, it would not be unreasonable to require that the remaining Federal grant lands be restored to Government owner-

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[84] Letter from Acting Secretary of Agriculture to the Speaker of the House of Representatives, cited in Congressional Record, April 29, 1942, p. 3789. Agriculture also would have exempted from such reconveyance and lands directly involved in railroad operation.

[85] Letter dated March 18, 1944 in "Repeal of Land-Grant Rates on Transportation of Goverment Traffic", Hearings on H.R. 4184, *op. cit.*, p. 314.

[86] Board of Investigation and Research, *op. cit.*, p. 142.

> ship, except for those which are used in carrier operations as right-of-way or for other purposes. This would be a relatively modest concession on the part of the railroads concerned, in return for the advantages they would gain in being relieved of the obligation to carry troops and military property for the Government at reduced rates. There are, moreover, positive reasons why it would be in the public interest to have much of this land restored to the Federal Government, in order to facilitate the sound administration of national reservations. If a final disposition of the land-grant problem is to be made, it may well be on the basis of concessions from both sides rather than by the Government alone.
>
> "The difficulties mentioned by the railroads do not appear to be insurmountable. It should be possible to effect the necessary release of grant lands from existing provisions of railroad mortgages, especially in view of the very substantial advantages which would accrue to the railroads and hence to their bondholders. Regarding the objection that it would be inequitable to require the several railroads which still hold substantial amounts of grant lands to release them, it may be observed that from much of the more valuable of these lands they have received income in rentals and royalties over a long period of years. Hence, as to those grant lands which have any considerable worth, it has not generally been necessary for a railroad to sell them in order to derive an income, and therefore the contrast between railroads which have sold their lands and those which have chosen to hold them should not be too sharply drawn.[87]

Congress declined to attach any condition for the return of unsold lands when, in 1945, it enacted final repeal of the land-grant rate concessions.

Regardless of the pros and cons of the fight over repeal of the land-grant rates, the foregoing analysis demonstrates, on many counts, the weaknesses of the railroad argument that those concessions repaid the government for the land grants themselves. The next part of this report is concerned with throwing additional light on important aspects of the argument which deserve further attention: the value of the unsold grant lands and the reserved mineral rights, which have been the subject of so much controversy, and the transfer of those lands and rights and thus the income they generate, from the railroad companies given the land grants for railroad purposes to holding companies or affiliates divorced from railroad operation.

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[87] Board of Investigation and Research, *op. cit.*, p. 142.

IV

Value of Railroad Grant Lands Currently Held

Railroads or their affiliates, principally the four major Western systems, today own millions of acres of land that were part of the original land grants given by the Government for railroad purposes. They also own mineral rights which they retained on additional millions of acres of grant lands previously sold. In the debates that have taken place in past years as to the relative amounts of Federal aid from which one or another mode of transportation receives financial benefit, the railroads have been silent about the current value of those lands and rights. It is no secret that on and under the surface of a large share of the railroad grant lands there are rich and bountiful reserves of natural resources—timber, coal, oil, other minerals—with which the lands were naturally endowed when the railroads received them, and that the flow of income from those reserves and from agricultural and commercial development of the land is impressively large and rapidly rising. No comprehensive accounting of the value of Federal assistance to the railroad industry can be considered complete—and no comparison of the financial benefits received by the various transport modes as a result of Federal aid can be considered valid—without an indication of the current value of the railroad grant lands, including mineral rights, presently held. But a definitive estimate of what that current value is has yet to be made.

Section 902 of the Railroad Revitalization and Regulatory Reform (4-R) Act of 1976 directed the Secretary of Transportation to prepare a "comprehensive study and analysis of past and present" Federal aid programs for the railroad industry and the relation of such programs to Federal aid for other modes. The Act gave the Secretary full power to require the railroads to file any information he deemed necessary for this study, including "the power to require by subpoena the production" of all books, agreements, documents, or other data considered relevant.[88] These powers were clearly sufficient to permit an intensive and accurate determination of the current value of the land grants still held by the railroads or their affiliates. In December 1976, Senator Russell B. Long of Louisiana, a member and subsequently chairman of the Senate Subcommittee on Surface Transportation, wrote to William T. Coleman, then Secretary of Transportation, seeking assurance that the following information would be included in the report:

> "A compilation and analysis of the current value of the government land grants now held by railroads or their affiliates. This would include establishing the flow of income, present and projected, derived by railroads or their affiliates from non-transportation use of those lands, including oil and gas, coal, and other operations."[89]

The Secretary's "Study of Federal Aid to Rail Transportation" was transmitted to Congress in January 1977. So far as the program of Federal aid to railroads through land grants is concerned, the report consisted of a brief treatment of the land grant program containing not a single reference to the extent, character, or value of the lands still held by the railroads or their affiliates or to the income generated from the devotion of these lands to non-railroad uses. Even if time did not permit development of such information for inclusion in the study as transmitted it is noteworthy that no follow-up investigation has been made by the Department of Transportation and no further report has been prepared.

Under Section 903 of the 4-R Act, the Interstate Commerce Commission was directed to "undertake a study of conglomerates and of such other corporate structures as are presently found within the rail transportation industry". In the course of this study, the Commission staff had to probe into the transfers of assets from the railroads to parent holding companies. Three of the major Western land-grant railroads—the Union Pacific, Southern Pacific, the Santa Fe—had established such holding companies and transferred assets to those companies which had been carried on the books of the railroads at about $600 million.[90] (The fourth railroad, the Burlington Northern, was precluded by the terms of a mortgage indenture from forming a holding company.) These three companies accounted for 90 percent of transfers of assets from all railroads to holding companies, and with the transfers of assets, typically accomplished by transferring former railroad subsidiaries, went the transfer of earnings generated by those assets. The Commission noted:

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[88] Public Law 94-210, 94th Congress, February 5, 1976.

[89] Letter from Senator Russell B. Long to Secretary of Transportation William T. Coleman, December 13, 1976.

> "[R]ailroad subsidiaries transferred to the holding companies owned valuable land and natural resources with potential to generate substantial investment and other income. Former subsidiary companies of three railroads (Santa Fe, Southern Pacific, and Union Pacific) have earned more than $802 million of pretax income from the time they were separated from the railroad companies through the end of 1975. . . ."[91]

The recorded book values, of course, did not reflect the true current value of the assets. As the Commission's report to Congress pointed out:

> "Book value, which usually is based on historical cost, does not, however, reflect the economic value of the assets removed from the railroads. For example, land grant lands and mineral rights may have no book cost assigned."[92]

The Commission's report went on to state:

> The Commission's staff attempted to ascertain the fair market value at the time of transfer and/or the current

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[90] "Railroad Conglomerates & Other Corporate Structures", *op. cit.*, p. 30.

[91] Ibid., p. 31.

[92] Ibid., p. 30.

> value of assets transferred. Estimates or appraisals of such values were not available in a definitive total value of such transfers. However, available information indicates the current value of the assets to be in the billions of dollars, particularly in light of the considerable coal, oil, and other energy reserves involved."[93]

In their representations to the Commission in connection with its Section 903 study, the railroads argued that the transfer of grant lands and other assets to holding companies or other non-rail affiliates has been good for the public and has strengthened their railroad operations. The statement submitted by the chairman of Santa Fe Industries, for example, put forth this view vigorously:

> "SFI was formed and the company was restructured in order to strengthen our overall corporate enterprise by facilitating diversification into non-rail business and maximizing development of our existing non-rail assets. These objectives have been realized to a considerable extent over the eight years since SFI's inception, and this has been accomplished with no adverse effect whatever on our railroad operations. On the contrary, those operations possess a quality today superior to that existing prior to formation of SFI. In short, I believe the formation of SFI and subsequent corporate restructuring has been of major benefit to the general public, which stands to gain from maximum development of our non-rail assets; to the shipping public, which can only benefit from the fact that Railway is part of a stronger, more stable enterprise; and to our stockholders, to whom management owes a fiduciary responsiblility to preserve and foster their investment."[94]

In its final report to Congress resulting from its investigation, however, the Commission expressed grave concern over the implications of these transfers of assets, and the income these assets produce, for the well-being of the railroad transportation system of the country:

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[93] Ibid., p. 31.

[94] Statement of John S. Reed on behalf of Santa Fe Industries, Inc., and the Atchison, Topeka and Santa Fe Railway Company, in Ex Parte No. 323, July 10, 1976.

> "The holding company structure has facilitated major removal of valuable noncarrier operating companies and other assets from some of the respondent railroad companies without compensation. Through a process of "corporate reorganization" or "restructuring" and subsequent dividends, several of the respondent railroad companies conveyed nontransportation and other assets currently worth billions of dollars to their parent holding companies. Some respondents have stated that these assets—principally land, natural resources, operating companies, and securities—were removed from the railroads in order to foster their profitable development free of regulatory restrictions and with no capital risks to the railroads. However, the loss of these assets has diminished current and potential earnings of the affected railroads and diverted income that was formerly used or available for transportation purposes by the railroads to the holding companies or other nontransportation affiliates. . . ."[95]

The asset transfers to which the Commission refers are on a total basis. No separate or complete compilation is available showing the acreage of grant lands and reserved mineral rights held by the Western railroad systems.

Some indications of the extent and current values of railroad grant lands and reserved mineral rights may be pieced together, however, from information developed by the Commission, as well as from other sources, including annual reports to stockholders, financial and operating data filed by the companies with the Securities and Exchange Commission, presentations made by the companies to financial analyst societies, articles in the business press based on interviews with company executives, and material filed with the Commission by individual companies and obtained from it under the Freedom of Information Act.

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[95] Ibid., p. 29-30.

Union Pacific

The current value of the Union Pacific land grant derives from the wealth of mineral resources—primarily oil and gas, low-sulphur coal, uranium, and trona—of the nearly one million acres of grant lands still owned by Union Pacific and from residual mineral rights reserved by Union Pacific on close to 8 million acres of lands previously sold.

The Union Pacific is a highly successful and profitable enterprise and income associated with the land grant is of major importance both in its present and in its prospective profit picture. Ten years ago, energy and natural resource operations of the company accounted for about 20 percent of its total net income after taxes. By 1978, that share had increased to 50 percent, representing over $120 million of after-tax net income, and is expected to go even higher than 50 percent in future years.[96] Income attributable directly or indirectly to the land grant represents a large and steadily increasing share of the total. The outlook is for that trend unquestionably to continue, and at a rising rate in the years ahead. While such income represents only in part the value of the mineral resources as such, there can be little doubt that even that part adds up to an impressive flow of income.

Until 1971, the Union Pacific's grant lands and its mineral and other non-transportation activities were held and undertaken as part of the Union Pacific Railroad Company. Under a corporate reorganization in that year, all of the non-transportation business and assets of the Railroad Company were, by means of a dividend, transferred to the Union Pacific Corporation, a holding company which had been incorporated in the State of Utah in 1969 and, through exchanges made in 1969 and 1971, had obtained 100 percent of the common and preferred stock of the Railroad. In 1970, the Railroad had acquired Champlin Petroleum Company and Pontiac Refining Corporation. These operations were consolidated with the existing oil and gas operations of the railroad, and were included in the assets transferred to the holding company.

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[96] Union Pacific Corporation, Presentation to Baltimore Security Analysts Society, May 15, 1979, p. 3.

Prior to the 1971 reorganization, all of the non-rail subsidiaries and non-rail assets of the railroad had been centralized under a single wholly-owned subsidiary, Union Pacific Development Corporation. The funds used to purchase Champlin and Pontiac at a total price of $278 million were provided by the Railroad. Early in 1970, Union Pacific Railroad advanced $120 million to Union Pacific Development to finance the first installment of the purchase price, and in 1971, before the reorganization, advanced to Development another $158 million to prepay the balance due to the seller, Celanese Corporation. As part of the reorganization plan, $178 million of the total $278 million was treated as a contribution of capital to Development and not repaid to the railroad.

On June 26, 1971, the reorganization date, the Union Pacific Railroad's board of directors, all of whom were also directors of the holding company, Union Pacific Corporation, declared a dividend to that corporation, representing the railroad's investment in Development, which investment had a book value of $370 million. Advances, loans, and contributions of capital, totaling $255 million, from the railroad to its former non-rail subsidiaries were included in this dividend. Of the $255 million, $178 million was the railroad's contribution of capital to Development for the purchase of Champlin and Pontiac. In the eighteen months preceding the dividend, the total amount of loans, advances, and capital contributions from the railroad to its non-rail subsidiaries had increased by approximately $200 million. The Commission later observed of this action: "Through this dividend, railroad assets having a net *book* value of $370.5 million were passed up to the holding company without compensation to the railroad."[97] (Emphasis in original)

The $370 million amount at which the assets transferred to the holding company were recorded on the books of the railroad far understated their actual value. A valuation study prepared in 1971 by William S. Cook, then Union Pacific's Vice-President-Finance, stated: "Because certain of these assets were initially acquired by the Railroad from the Federal government and were never given any ledger value, there is reason to question whether the Railroad's book investment in Development Corporation equates to the value of the underlying assets."[98] The study put a value of $662 million on the assets transferred.

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[97] Railroad Conglomerates and Other Corporate Structures", *op. cit.*, p. 31.

Before effectuating the 1971 reorganization, the company engaged the First Boston Corporation to value the properties to be transferred. The studies of that firm produced a valuation of $480 million. As the Union Pacific later stated to the Commission five years later, "the report was prepared in the context of the world and the future as then perceived. . . ."[99]

The world of energy economics, prices, and values has altered drastically since 1971. The grant lands and mineral rights to grant lands contain between 10 and 15 billion tons of reserves of low-sulphur coal, to say nothing of great reserves of oil and gas. In addition, the Union Pacific land grant area contains substantial reserves of uranium and truly vast deposits of trona, the main source of soda ash in the United States.

In a notable piece of understatement, the Commission, in commenting on the valuations of $662 million and $480 million, observed: "While both of the above methods of valuation may be valid, each may have understated the potential value of natural resources, particularly coal, in light of the energy shortage that developed since the date of transfer."[100] An earlier internal memorandum prepared by the ICC Bureau of Accounts and transmitted by the Commission to the House

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[98] "Present Value of Non-Transportation Assets of Union Pacific Railroad Company", Study prepared by William S. Cook, Vice-President-Finance, June 18, 1971, p. 1.

[99] Statement of Union Pacific Corporation and Union Pacific Railroad Company, submitted in Ex Parte No. 323, Interstate Commerce Commission, July 10, 1976, p. 17.

[100] "Railroad Conglomerates and Other Corporate Structures", *op. cit.*, p. 31.

Oversight Subcommittee estimated the 1971 fair market value of the railroad assets transferred at $975 million.[101]

Coal

Union Pacific owns immense coal reserves located chiefly in Wyoming, with some reserves in Colorado and Utah as well. The Cook study in 1971 stated that "it is estimated that these reserves contain 15 billion tons of recoverable good quality, low sulphur coals, which are suitable both for electric power generation and conversion into liquid and gaseous hydrocarbons. The majority of these reserves are on land grant acreages in a checkerboard pattern intervened by Federal and State government lands."[102]

In 1972, the Union Pacific's then-chairman, Frank Barnett, summed up for a journalist the company's program for developing the coal on its lands: "We have the muscle to proceed and we have the coal reserves."[103] Coal production on Union Pacific lands has since been increasing at a steep rate. Output rose from 4 million tons in 1973 to over 11 million tons in 1979, and is scheduled to reach 17 to 18 million tons in 1980. With additional mine openings already firmly scheduled by 1984, the annual rate of coal production will continue to climb sharply. According to a lengthy financial-journal article dealing with the outlook for coal production on Union Pacific lands, "by 1985, if all goes according to plan, the figure should be 32 million tons. This alone could, by *Forbes* estimates, produce $95 million in UP profits."[104]

The company has stated that two billion tons of its coal reserves "are now economically mineable."[105] This statement appears quite conservative in light of current and prospective developments. Obviously, as energy prices, powered by the price of oil, continue their upward course, more and more coal deposits become economically feasible to develop. Furthermore, the Union Pacific has long argued that the scale of its coal production and income could be significantly expanded if leases could be obtained on Federal lands adjacent to the land grant sections: "Because almost all of Union Pacific coal producing properties lie beneath land-grant acreage, the ownership is laid out in a checkerboard fashion representative of the initial grants which were of alternate odd-numbered sections. Research into the most desirable method of developing these properties has indicated that while it would be economically feasible to surface mine solely on Union Pacific property, other strip and deep mine operations could only be considered where adjacent even-numbered parcels were included. The major portion of Union Pacific's substantial coal deposits can be recovered only through deep mining."[106] It is significant, therefore, that the outlook for such leasing is more favorable. As Union Pacific's president recently put it: "We expect the moratorium on leases to change. The Secretary of the Interior is working on a program which is expected to have the Federal government back in the business of leasing in 1980."[107]

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[101] "Regulatory Reform-Volume III, Interstate Commerce Commission" Hearings before the House Subcommittee on Oversight and Investigations, Committee on Interstate and Foreign Commerce, 1976, p. 331.

[102] "Present Value of Non-Transportation Assets of Union Pacific Railroad Company", *op. cit.*, p. 15.

[103] Forbes, November 15, 1972, p. 46.

[104] Robert F. Flaherty, "The Great Big Railroad That Could", in Forbes, June 1, 1977, p. 42.

[105] Presentation to Baltimore Security Analysts Society, May 15, 1979, p. 9.

Oil and Gas

Union Pacific Corporation chairman James H. Evans has stated:

> "The first major factor in our corporate progress is the ever-growing importance of the Union Pacific Land Grant. This 40-mile-wide belt—which spans Colorado and Wyoming and laps up against the Great Salt Lake—stretches across the 'hottest' petroleum exploration territory in the Rocky Mountains. It is one of the most active onshore areas in the United States today. . . . Union Pacific's min-

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[106] Statement of Union Pacific Corporation, Ex Parte No. 323, *op. cit.*, p. 12.

[107] Union Pacific Corporation, Presentation to the Houston Society of Financial Analysts, November 1, 1978, p. 18.

> eral rights on the Land Grant will enable it to participate both directly and through royalties in oil and gas production from the Rocky Mountain area."[108]

All oil and gas operations of Union Pacific Corporation are now centralized in its Champlin Petroleum operating subsidiary. Champlin is a fully integrated oil and gas enterprise engaged in exploration, development, and production of crude oil and natural gas and the refining, processing, transportation, and marketing of petroleum products, with sales of well over $1 billion. As noted earlier, Champlin was originally purchased largely with railroad company funds and then transferred to the holding company as a dividend from the railroad.

In addition to exploration and development programs of its own, Union Pacific in 1969 entered into an 8-year agreement granting Amoco Production Company, a subsidiary of Standard Oil of Indiana, oil and gas exploration, development, and leasing privileges on 6.8 million of the 7.9 million acres of the land grant on which Union Pacific had retained mineral rights. During the period of this agreement, Union Pacific earned $84 million in option payments, production, and production royalties. Under the agreement, Amoco drilled 2,615 wells, 1,387 of which were successful oil and gas producers. Union Pacific participated in drilling 179 wells, of which 141 were successful.

Union Pacific estimates that its reserves of natural gas as of the end of 1978 totaled 1.25 trillion cubic feet, an increase of 30 percent from a year earlier. Its net proved reserves of crude oil, condensate, and plant liquids were 114 million barrels. The company is engaged in an ambitious program to develop the highly promising petroleum resources of the Union Pacific land grant holdings in the rich Overthrust Belt. The company recently stated: "We anticipate that the Overthrust eventually will yield a total reserve of oil and gas equivalent to several billion barrels. Champlin's stake in wells drilled in Land

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[108] Union Pacific Corporation, Presentation to Boston Security Analysts Society, October 18, 1976, p. 5. (Mr. Evans was at that time President of the Corporation.)

Grant portion of the Belt has averaged approximately 18 percent."[109]

Trona

Another major mineral resource of the Union Pacific land grant is the world's largest deposit of trona, from which soda ash, a major industrial chemical, is derived. Soda ash is a key ingredient in the manufacture of glass, detergents, and other products, and three-fourths of the United States consumption is supplied from Wyoming trona deposits. Most of these reserves lie within the Union Pacific land grant and are owned jointly by the company and the Federal Government. Total trona reserves in Wyoming are estimated at 50 billion tons. One-half of this total belongs to the Union Pacific land grant and was transferred along with the land themselves from the railroad to the holding company at the time of the corporate reorganization.

Despite the transfer of assets to the holding company, the Union Pacific railroad system has long been regarded as one of the strongest carriers in the nation from a financial and operating standpoint. Its capital expenditures are high, its equipment is modern, and its roadway extremely well maintained. Union Pacific has described its railroad as "the most profitable transportation company in the country."[110] In a recent statement, the company has stated:

> "In spite of some gloom and doom in some quarters of the railroad industry, we believe that the Union Pacific Railroad has an outstanding future."[111]

Southern Pacific

As of December 31, 1976, Southern Pacific subsidiaries owned over 3.7 million acres of land, mostly in California, Nevada, and Utah and had mineral rights or royalty interests in an additional 1.5 million acres, according to a filing with the Securities and Exchange Commission. Earlier, the Southern Pacific had confirmed in a statement to the Interior Department that in 1971 its retained land grant acreage was 3.8 million acres and the amount of previously-sold land in which it retained mineral rights was 1.2 million acres.[112]

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[109] Presentation to Baltimore Security Analysts Society, *op. cit.*, p. 9.

[110] Presentation to the Houston Society of Financial Analysts, *op. cit.*, p. 3.

[111] Presentation to Baltimore Security Analysts Society, p. 6.

The land grants donated by the Federal Government to the Southern Pacific contained extensive reserves of oil and timber, and included broad and rich agricultural acreage. A previous chapter discussed some aspects of the litigation which revolved around the oil lands of the Southern Pacific in the early part of the present century. Daggett's history of the Southern Pacific states:

> "The peculiarity of the oil land litigation, and the reason why the federal government is involved, is found in the fact that the railroad land is mostly land-grant land, lying within the limits laid down by the Act of 1866 from which the Southern Pacific Railroad took its life. It follows from this that the railroad title was affected by certain reservations in the land-grant legislation, such as that exempting mineral lands from the operation of the grants. . . . [T]he exception of mineral lands was repeated in the patents later issued by the Department of the Interior, and in such patents the words, 'excluding and excepting all mineral lands should any such be found in the tracts aforesaid', were used, making the exemption apply to future discoveries as well as to discoveries occurring before the patents were issued."[113]

As noted in the earlier chapter, the Supreme Court held in a 1914 case that the issuance of patents to the land insulated the Southern Pacific from the operation of this clause in the patents themselves unless fraud could be proved. In the *Elk Hills* case, decided in 1919, the Government succeeded in showing fraud and won cancellation of the railroad's patents to the land.[114] In a second group of cases, decided in the District Court that year and not appealed, the Government failed to make the necessary showing;[115] these cases involved most of the Southern Pacific's oil lands.

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[112] Reply to Administrative Complaint, *op. cit.*, p. 10.

[113] Daggett, *op. cit.*, p. 442-443.

The oil lands in question had a value at that time, according to Government estimates, of over $400 million. They had been transferred to a wholly-owned subsidiary, the Southern Pacific Land Company. Daggett states:

> "In June, 1920, however, the Southern Pacific Land Company owned 19.38 percent of all the proven oil land in California. . . . Unquestionably the Southern Pacific oil lands are valuable. A witness in one of the recent cases testified that he had told Mr. Huntington in 1893 that the railroad oil lands were worth more than the entire Southern Pacific Railroad, while it is common report that the value of the properties may run into the hundreds of millions of dollars."[116]

Shortly after the Elk Hills and other cases came to an end, the Southern Pacific decided to spin off its oil lands to stockholders. It did this by forming, in 1921, a new subsidiary, the Pacific Oil Company, which purchased all of the Southern Pacific interest in the oil lands. The funds for the purchase by Pacific Oil Company came from Southern Pacific Company subscriptions to its stock. Southern Pacific Company then disposed of that stock to its own shareholders by giving them the right to purchase, on a share-for-share basis, Pacific Oil Company stock at the subscription price paid by Southern Pacific.

Daggett says of this transaction: "Commenting on the plan for the separation of the oil and railroad properties, President Sproule observed that the plan was simply responsive to the spirit of the times. It seems likely, however, that it will have the additional result of preventing further action tending to disturb the railroad title.'[117]

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[114] United States vs. Southern Pacific Company, 251 U.S. 1 (1919).

[115] United States vs. Southern Pacific Company, 260 Fed. 511 (1919).

[116] Daggett, *op. cit.*, p. 441-442.

Prior to 1970, considerable acreage had already been separated from the railroad subsidiary, Southern Pacific Transportation Company, and were in the hands of an affiliate, Southern Pacific Land Company, both are wholly owned by Southern Pacific Company, the parent holding company.

Over the next four years, through a series of special dividends, Southern Pacific Transportation Company transferred assets with a recorded book value of $135 million to the holding company. Included in these transfers were about 2 million acres of land, which included most of the remainder of the land grant, and title to the 1.2 million acres of mineral rights on other lands, chiefly grant lands previously sold but with mineral rights reserved. The value of the lands and mineral rights transferred from the railroad company was alluded to in the ICC report on "Railroad Conglomerates":

> "A consulting firm hired by SPCO (Southern Pacific Company) estimated the value of the lands transferred to the holding company to be $391.2 million at the time of transfer. They also projected the appreciated value of the same land at $557.1 million, $697.1 million, and $903.0 million in the years 1975, 1980, and 1985, respectively. SPCO management discounts the validity of their consultant's estimates but, since this study was completed in 1970, it is probable that the estimated values of mineral rights, as with the UPC (Union Pacific Corporation) study estimates, were conservative by today's standards.[118]

It is difficult from available data to trace the annual income derived by Southern Pacific from the grant lands it holds, but there can be no question that it is substantial. The land subsidiary earned $20 million of revenue from its timber stands in 1976, and with great increases both in stumpage price and the amount of timber cut the earnings from this source have probably climbed sharply. Income from oil and from agricultural and other leases is also significant and rising.

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[117] Ibid., p. 449.

[118] Railroad Conglomerates & Other Corporate Structures, *op. cit.*, p. 33.

Santa Fe

The Santa Fe still holds substantial acreages of land-grants and retains mineral rights in another 4.2 million acres of that part of the land grant which was previously sold.

The proved coal reserves on Santa Fe lands are estimated at about 600 million tons, located mainly in New Mexico, Colorado, and Kansas. Deposits on several of the properties are under active development. The company has entered into lease arrangements with Texas Utilities and with Tucson Gas and Electric, involving 370 million tons of coal. Under the lease with Texas Utilities, the coal mined from the properties, which are located in the San Juan Basin of New Mexico, is expected to produce advance royalty payments of roughly $700 million to the Santa Fe over the next 30 years; payments are projected at about $5 million in 1980, rising to $22 million by 1990, and will average $25 million a year thereafter. In total, Santa Fe is scheduled under existing agreements to receive minimum royalty payments of $1.6 billion for coal extraction on its properties over the next 46 years, an average of about $35 million a year. This commitment is expressed in 1978 dollars; contract escalation provisions are designed to offset effects of future inflation.

In 1970, the Santa Fe railroad transferred to Santa Fe Industries, its parent holding company, about 154,000 acres of land-grant lands and the retained mineral rights to grant lands previously sold. These assets had no recorded book value. In its transmittal to the House Oversight Subcommittee, the ICC estimated their 1970 fair market value at $300 million.[119]

Burlington Northern

The Burlington Northern is successor to the Northern Pacific Railway, which was the recipient of the largest land grant made to any of the railroads, about 40 million acres, and to the Great Northern and the Chicago, Burlington & Quincy, which together received about another 7 million acres. The Burlington Northern at present owns outright about 2.4 million acres of land, the bulk of which derives from the land grants. About 1.5 million acres of this total is in timberlands in the western states. In addition, the Burlington Northern owns mineral rights on more than 6 million acres, including about 5 million acres on which it owns all mineral rights and 1 million acres on which it owns coal and iron rights only.

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[119] "Regulatory Reform-Volume III, *op. cit.*, p. 332.

Because of mortgage indenture restrictions, the Burlington Northern is prevented from establishing a holding company and transferring to it land and other assets held by the railroad, as has been done in the case of the other three major Western railroad companies, the Union Pacific, Southern Pacific, and Santa Fe. The rather traditional structure under which it operates does not appear to have interfered with the BN's successful development of the natural resource wealth of its lands. The Interstate Commerce Commission, noting in its report to Congress on railroad conglomerates that "the earnings from the development of these natural resources has helped the railroad to sustain its transportation operations", added that "the example of Burlington Northern, Inc. tends to refute the argument offered by respondents in Ex Parte No. 323 who maintain that the holding company structure is essential to the profitable development of the illiquid nontransportation assets of the railroads."[120]

Located on the lands of the Burlington Northern are 14.7 billion tons of reserves of low-sulphur coal considered by the company as economically mineable, about 7 billion tons of which are already under lease, with the remainder being held for profitable opportunities for joint ventures to convert the coal into synthetic diesel fuel, chemicals, and other products as well as to sell the coal to electric utilities. Another 50 billion tons of coal is estimated by the company to lie in unproven reserves under its lands. No coal company in the United States matches the Burlington Northern's reserves. In 1979, coal production totaled about 16 million tons, over half again as much as the preceding year, and the prospective trend is sharply upward.

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[120] "Railroad Conglomerates & Other Corporate Structures", *op. cit.*, p. 30.

Substantial income is also derived from 1.5 million acres of timberlands owned in Montana, Idaho, Oregon, and Washington. In 1976, about 300 million board feet of timber was cut on Burlington Northern lands, both for sale and for processing into various lumber, plywood, and other products in BN's integrated wood utilization operation.

A quantification of the current value of railroad grant lands and the income they produce is relevant to much of the legislation involving railroads and their competitive relationship to other modes. Such legislation—whether dealing with Government help the railroads seek for themselves or handicaps they seek to impose on competitors—has frequently been influenced by comparisons of the amounts of aid which the railroad industry and competing modes have received in the past. To be reliable, such comparisons must give due weight to the present economic values the railroads enjoy by dint of the extensive and productive acreages of land grants they still hold.

It is apparent from our review that, even if difficult to isolate, the true current value of the grant lands owned by the railroads and the mineral rights reserved on lands previously sold is of large magnitude. It should also be clear that, in future Congressional policy decisions involving competitive relationships between railroads and other modes, a more precise accounting of the economic value of those lands, including the income they generate, is needed. Congress recognized that need when, as part of the Inland Waterways Revenue Act of 1978, it decreed a broad study comprising an evaluation and comparison of the benefits resulting from all forms of Federal assistance to the various transportation modes, including "revenues from land grants."[121] The interest of the public in such an accounting is rooted not only in the need for better-informed Congressional action relating to transportation, but also in the need for assurance that public lands given for railroad use will not be diverted to non-railroad use. As the ICC emphasized in its report to Congress on railroad conglomerates:

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[121] Public Law 95-502, 95th Congress (1978).

> "We are particularly concerned that lands which were granted by the Federal Government to railroads to enable them to fund the construction and operation of their rail lines—or the proceeds from the transfer of those lands or of interests in those lands—have been and will be transferred from the railroads to their parent holding companies at less than fair value. Were the railroads receiving these properties, or their railroad successors in interest, to be deprived of the fruits of these land grants at a time, whether now or in the future, when they are needed to support rail services essential to the public interest, the intention of the Congress in making these grants would be subverted, and today's citizens would lose the benefit of the contract made by their forebears with the land-grant railroads."[122]

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[122] "Railroad Conglomerates & Other Corporate Structures", *op. cit.*, p. 74.

V

Conclusion

The railroad land grants represent not merely an interesting and important chapter of American economic history but are relevant to major current issues of Congressional policy dealing with the transportation system of the nation. One of those issues involves the relative financial benefits which competing modes of transportation have received from government assistance. Another involves the questions raised by the transfer of those lands, together with the income they produce, to holding companies.

The land grants form a substantial part of the benefits which the railroads have received from Government. Aside from the vital role of the lands in attracting capital for the construction of major portions of the railroad system and in generating substantial operating funds, the resources with which the lands were naturally endowed have been and still are a major source of revenue. Contrary to the claims made by the railroad industry, the "repayment" to the Government through railroad rate concessions on Government traffic in effect until 1946 do not come close to offsetting the benefits received by the railroads from the grants. Comparisons made by the railroad industry greatly overstate the extent of those concessions made by the land-grant railroads themselves, omit numerous relevant factors, and fail to place the rate concessions made by the railroads and the land grant benefits received by them on an actuarially comparable basis. Even if no allowance is made for the current value of the lands still held by the railroads, analysis shows that the benefits to the railroads greatly overshadow the repayment. Furthermore, the financial burden of the rate concessions that were made was actually borne not by the railroads but by commercial shippers who were charged higher rates to make up for any railroad revenues lost because of lower rates charged the Government.

There can be no question, however, that the current value of the grant lands presently owned by the railroads, including the reserved mineral rights on lands previously sold, must also be taken into account in order to make significant any comparison of the financial benefits received by railroads from government assistance in relation to the benefits received by other modes. The Western railroads own several million acres of land derived from the land grants as well as mineral rights on additional millions of acres of previously-sold lands. The resource wealth of these lands can fairly be described as enormous. Current and prospective demand for coal, petroleum, other minerals, and timber insures that the income derived from the grant lands will grow rapidly in the years ahead.

Despite the clear relevance of the current value of the land grants to issues of national policy, no public accounting of the value of these lands has been made. These lands came from the public domain, and Congress should make sure that a comprehensive and accurate accounting of their present economic value, including the income they produce, is publicly available. The desirability of such an accounting has been made more urgent by the large-scale transfers of the grant lands from the railroads—to which they were given for railroad purposes—to corporate holding companies or affiliates having no direct responsibility for providing railroad service and no accountability to the regulatory agency which Congress has designated to protect the public interest with respect to such service.

It is questionable whether the Interstate Commerce Commission has the power, or inclination, to require the railroads to supply the necessary data, or whether in the absence of further Congressional directives, the study of Federal assistance to transportation, as recently mandated by statute, will yield such data. It may well be that the needed accounting can be developed only through an investigation by Congress itself.

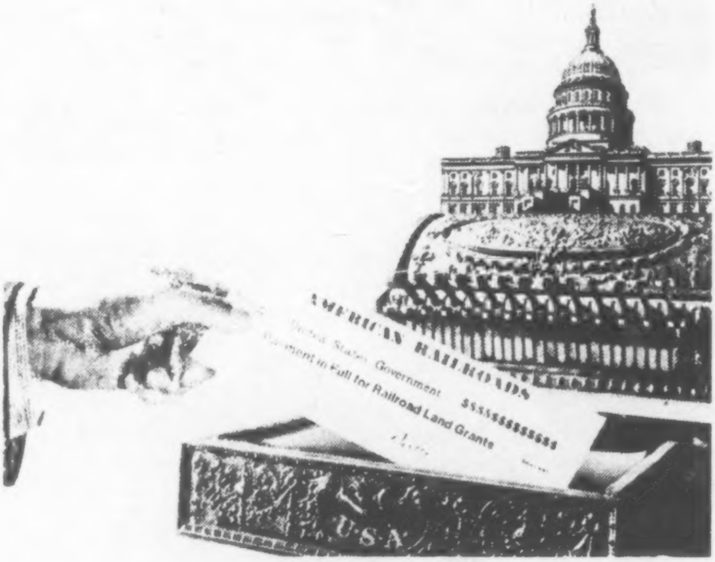
Such an investigation could also provide an appropriate vehicle for Congressional inquiry into the broader issues which the Commission has raised concerning the importance of making sure that the grant lands will continue to be used in the public interest as Congress intended. Those issues prominently include the transfer of grant lands from the land-grant railroads themselves to conglomerate holding companies. A concomitant of the transfer of the lands has been the transfer of the very substantial income generated by the extensive coal, oil and gas, timber, and other resources those lands contain. Representations concerning the financial needs of the railroads color virtually every significant piece of legislation affecting that industry, yet the income currently derived from grants of public lands given by the government for railroad purposes is no longer regarded as railroad income.

The issues raised by the Commission and the proposals it has put forth for dealing with them warrant close consideration by the Congress along with the development of an accurate accounting of the economic value of the grant lands and mineral rights presently held.

The economic consulting firm of Jesse J. Friedman & Associates, which since its inception in 1954 has acted in an advisory capacity to business corporations and associations in a wide range of regulated and unregulated industries, is headed by Jesse J. Friedman, whose experience as a government official and a consulting economist has embraced many aspects of public policy in relation to industry. On numerous occasions Mr. Friedman's work has involved the study of the implications of government and business policies for the public interest. He was staff director of a cabinet committee established by President Truman on problems of competition and monopoly and has served as economic consultant to the Antitrust and Monopoly Subcommittees of both the United States Senate and the House of Representatives, to the Senate Committee on Interstate and Foreign Commerce, and to the Department of Commerce, Department of Justice, and various state agencies. His studies published by Congressional Committees include *Concentration in American Industry, Corporate Mergers and Acquisitions,* and *Merger in a Regulated Industry*. In private consulting, he has made and directed studies and advised corporations and their counsel on the economic soundness of government and business policies relating to regulation, competition, pricing, profitability, investment, and the determination of revenue and income needs. He has dealt with varied economic issues in air, motor, rail, and water transportation. Among recent writings, he is co-author of a study of *Relative Profitability and Monopoly Power*, published in 1972, and the author of *A New Air Transport Policy for the North Atlantic,* published in 1976, and of *Collective Ratemaking in Trucking: The Public Interest Rationale, Parts* I *and* II, published in 1977-78.

Competitive Equity Issues —
First in a series.

RAILROAD LAND GRANTS:
Paid For in Full


AMERICAN RAILROADS
United States Government
Payment in Full for Railroad Land Grants
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U.S.A.

An Historical, Economic and Legal Interpretation of Public Policy Which Encouraged the Building of Transcontinental Railroads

By Frank N. Wilner
Association of American Railroads
Washington, D.C. 20036
August 1981

Suum quaque in annum referre
...Refer everything back to its own year.

INTRODUCTION

Perhaps no issue has similarly fascinated historians, economists, and attorneys as the issue of railroad land grants. During the mid-1800's, railroads, as homesteaders, highway builders, and canal builders before them, were the recipients of free Federal lands. The Federal government, with a seemingly infinite amount of undeveloped land on its hands, traded this land to hearty souls sufficiently bold to settle on and develop the forbidding Great Plains.

The era of railroad land grants should be of little more than historical interest today. Congress and the courts long ago closed the books on railroad land grants. The record is complete and the conclusions straight forward. The railroads more than repaid the Federal government for the value of lands granted.

Unfortunately, the nation's barge and heavy truck operators, which are today receiving billions annually in rights-of-way subsidies, are spreading specious arguments regarding past railroad land grants in an effort to prevent a reformulation of public policy which would require all modes--railroads included--to compete solely on the basis of market forces and not subsidy.

The matter of past railroad land grants is as irrelevant as the matter of past barge and heavy truck subsidies. Though the U.S. Department of Transportation found that past Federal aid to barges and heavy trucks has far exceeded the value of past Federal aid to the railroads, the railroads do not suggest that barge and heavy truck interests repay past aid. The focus of economic analysis and public policy should be not on sunk costs, but on future costs.

This fact was borne out by a Department of Transportation spokesman, Richard F. Walsh, Director of DOT's Office of Economics and Public Investment, who, in response to these land grant allegations, told a Senate Subcommittee June 16, 1981:

> These were all legitimate public policy objectives and didn't and shouldn't have anything to do with the principle of full cost recovery over the long run for all modes.

Mr. Walsh also said that raising questions about a mode's past Federal assistance "is not a particularly helpful way" to view this matter of competitive equity.

BACKGROUND

Unfortunately, when one repeats a myth sufficient numbers of times, the myth tends to become conventional wisdom unless challenged by truth. To counter the specious and irrelevant arguments of the barge and trucking industries regarding century old railroad land grants, we have prepared this paper providing the facts as established by the Federal government and Federal courts.

During the 20 years from 1837 to 1857, approximately 130 million acres of Federally-owned lands were deeded by the Federal government to states and private sector interests to facilitate the building of railroads. The justification for railroad land grants was both to ensure the defense of the West Coast from the British, and to exploit the Great Plains which appeared to stretch endlessly west from the Allegheny Mountains, and which seemed to have no value absent available and dependable transportation.

For years, there was a general fear in Congress that without a means of linking the West Coast with the East, California and other western possessions might be lost. In 1861, a U.S. Navy ship stopped a British mail packet, the Trent, removed two Confederate diplomats, and carried them to Boston. In the British view, this constituted a clear violation of international law and a threat of war resulted which did not subside until the two men were released. The incident was called the Trent Affair, and it alerted the American public to the indefensibility of the U.S. West Coast. Congress was told that in the event of war, the British fleet had orders to seize California.[1] The significance of railroads for military purposes had been discerned as soon as railroads were developed after 1827. Railroads carried troops rapidly, allowing them to arrive in good physical condition; allowing reservists to support regular troops; and allowing greatly improved supply.[2]

Whether the modern traveler chooses an airline, Amtrak, motor coach or automobile, the trip across the western plains hardly suggests an amorphous Great American Desert. But that is precisely how many map makers described the territory west of the Missouri River prior to 1850.[3] "An immense wild Eden to be conquered," was another description.[4]

Travel by wagon freighter on the overland route, which took the traveler along the Santa Fe Trail, required an entire summer, and was considered more hazardous than the ocean voyage around Cape Horn, which itself required five weeks.[5] Visitors from the East, who chose the overland route, trickled in by wagon, by stagecoach, by horseback, or on foot.[6]

It is no wonder that building of railroads linking the Pacific with the eastern United States became as much of a preoccupation among many Americans as the concept of manifest destiny. In fact, to a large extent, railroad building and manifest destiny were inseparable. Federal assistance, it was believed, was the necessary catalyst for railroad construction, which would allow development of western lands.

Until transportation made such markets accessible, the lands west of the Allegheny Mountains had little value.[7] To transport a heavy load any distance was so time consuming and expensive as to be generally impractical.[8] Federal encouragement of railroad building could change that.

The concept for land grants was not new, however. Such Federal and state aid had already been granted to encourage, hasten and complete highway and inland navigation projects. For example, between 1827 and 1866, Congress granted 4.6 million acres of public lands to aid canal development, and 1.7 million additional acres were granted for navigation improvements on rivers.[9] The building of a national road, which was to stretch from Baltimore more than 800 miles to Illinois, was authorized in 1806, and, in 1822, President Madison vetoed a measure which would have authorized the collection of tolls on the national road.[10] Through the General Survey Act of 1824, Congress authorized the use of civilian and military engineers to conduct surveys and prepare plans and estimates for roads and canals of national importance.[11]

Federal participation in railroad development was seen as a natural extension of Federal aid benefiting waterways and highway development. The Federal government began its aid to transportation in 1789 in the form of harbor improvements, with the nation's first public works project being a lighthouse at Cape Henry, VA.[12] In 1791, Treasury Secretary Alexander Hamilton published his "Report on Manufactures," in which he extolled the advantages of Federal action to exploit the resources of the interior.[13] The outbreak of European wars in 1793, creating disruptions in foreign trade, caused Colonial leaders to focus upon the resources of America's interior. Initiated was the Era of Internal Improvements, beginning with Federal aid for canal and highway development, and later extending to railroad development.

According to the U.S. Department of Transportation, since Colonial times, Federal aid for highways has exceeded $88 billion; for airport and airways development almost $26 billion; for inland navigation development and maintenance more than $14 billion; and for freight railroads about $860 million (including land grants, but not including the $3.3 billion in Conrail aid and about $257 million in mostly midwest railroad loan guarantees.)[14]

EVOLUTION OF RAILROAD LAND GRANTS

When the State of Maryland chartered the Baltimore and Ohio Railroad (the nation's first railroad) in 1827, the United States entered an era of feverish railroad building.[15] By 1840, more than 2,800 miles of track had been laid in the eastern United States, and by 1850 the figure was 9,021 miles.[16] These private enterprise undertakings demonstrated that railroads could provide economical transportation and compete successfully with water carriers.[17] Congress viewed canals as having climatic limitations and saw railroads as having the ability to link the area east of the Allegheny Mountains with the West.[18] Aside from the New York State-financed Erie Canal, and a few others, most canals ran north-south when economic development was proceeding east-west.

Beginning about the time of the Webster-Ashburton Treaty of 1842 (which defined a northern boundry for the United States and created Washington territory), there was agitation for a railroad to the Pacific.[19]

After discovery of gold in California and California's subsequent admission to the Union in 1850, a host of measures were presented in Congress for a railroad to the Pacific. In 1856, Presidential candidates Lincoln and Douglas favored such a project.[20] Indeed, Horace Greeley went so far as to calculate the economic feasibility of a proposed railroad line by estimating the potential revenue, based upon the value of current shipments of gold from California east, and passenger fares. He even included, as a cost to the government, the movement to and maintenance of an army in the West.[21]

Jefferson Davis, Secretary of War from 1852 to 1856, published a 10-volume "Report on Explorations and Surveys to Ascertain the Most Practicable and Economical Route for a Railroad from the Mississippi River to the Pacific Ocean."[22] Davis favored a southern route from Ft. Smith, Arkansas, through Texas, New Mexico and Arizona.[23] He also indicated that a northern route through Nebraska and Utah, or a central route through Missouri and along the Santa Fe Trail, were also possibilities.

The first land grants to facilitate railroad development were not made to railroads, but rather directly to the states involved. For example, in 1850, President Fillmore signed a bill granting directly to the State of Illinois a right-of-way 200 feet wide plus alternate sections of public land for six sections on each side of the right-of-way for a railroad from Cairo to Galena, with a branch to Chicago.[24] Similar grants were made directly to the States of Mississippi and Alabama, assuring a railroad from Chicago to Mobile.[25] This became the Illinois Central Railroad.

These grants, however, were not without restrictive provisions. In return for the Federal lands being granted to the State of Illinois (which was to sell the lands to raise capital for construction costs), the following conditions were imposed on the Illinois Central Railroad:[26]

1) The railroad was to be completed within 10 years, or unsold land would revert to Federal ownership, and land disposed of would become a debt of the states to the Federal government at a preemption price of $2.50 per acre.

2) All Federal property and troops were to move over the railroad free of charge, and Congress would set a rate for the movement of U.S. mail. Other land grant recipients were required to move Federal property at 50 percent of established rates and mail at 80 percent.

3) The railroad was to pay the State of Illinois 7 percent of the railroad's gross receipts on a semi-annual basis. From March 24, 1855, to April 30, 1880, the State of Illinois collected $8.1 million in such taxes on 2.6 million acres of land sold for the original benefit of the railroad--and the taxes continued.

No similar conditions had ever been imposed in return for Federal land grants and other aid for highways and navigation improvements. By 1859, some 50 railroads had been established as a result of the policy of the Federal government making land grants directly to the states. Some 33 million acres of public lands had been given the states, for subsequent sale by the states, to raise capital for railroad construction. Some 8,647 miles of railroad were constructed or were under construction by 1859 as a result of this program.[27] Congress immediately doubled the selling price of the alternate sections of land it retained in order to recompense the United States for what was given away, though the windfall was never credited to the accounts of the railroads when the Federal government, almost a century later, attempted to determine if the aid had been repaid.

(The Secretary of Transportation points out that much of the lands granted had been available for sale for 15 to 30 years at a price of $1.25 per acre, but proved to be unsalable because of inaccessibility to markets and population centers. The entire cost of the public domain was about 17 cents per acre, including survey, disposition and quieting of hostile Indians. Until the railroads were built, there was just no demand for this land[28]).

Despite early land grant assistance for a relatively few western and southern railroads, the American railroad network was generally a phenomenon of private ownership.[29]

The economic necessity of exploiting the newly acquired western lands, and the military necessity of defending those lands, led to the passage in Congress of The Union Pacific Act of May, 1862, and the incorporation, on July 1, 1862, of The Union Pacific Railroad Co. The UP was to build a railroad and telegraph line from the Missouri River at Council Bluffs to California, and was to be granted for that purpose 10 sections of land per mile in checkerboard fashion, to be patented upon the completion of each 40 miles of railroad.[30] (A section of land is one-square mile.

To permit the granting of 10 sections of land per mile, in checkerboard fashion, the grants extended 10 miles on each side of the right-of-way). The purpose of the land donations in excess of the needed right-of-way was to provide an asset base upon which the capital needed to construct the railroad could be borrowed.[31]

Concomitantly, the Act authorized the Central Pacific Railroad of California to build from Sacramento east, until junction was made with The UP.[32] The CP received a similar checkerboard land grant. The central route, rather than the southern route championed by Jefferson Davis, was chosen because representatives from southern states, which had seceded from the Union, were no longer present in Congress to continue the dispute over the favored route.

By 1864, two years after the central route was chosen and construction began, it became clear that the original grant was not sufficient to attract the capital to build a central Pacific railroad across the plains and mountains.[33] As the military significance of railroads had already been amply demonstrated during the Civil War, Congress believed it essential a railroad be completed.

Thus, a second Pacific Railway Act was passed in 1864, increasing the land grants to 20 alternate sections per mile to "do enough and only enough," to induce capitalists to build the Pacific railway.[34] Construction continued and the railroads joined at Promontory, Utah, May 10, 1869, to complete an 1,800 mile route. Again, by retaining alternate sections of land, and immediately doubling the selling price from $1.25 per acre, to $2.50 per acre, the Federal government recovered the value of the lands it had granted. And, as was the case with the Illinois Central, this windfall was never credited to The UP when the Federal government sought to put a value on land grants and determine the extent of repayment by the recipients. The Federal government had put a high priority on sale of these lands, in part to relieve the Revolutionary War debt, and in part to recover the lands' acquisition costs.[35]

(The English, by virtue of the voyages of the Cabots along the eastern coast of the New World in 1498, acquired title of first discoveries. Possession followed through colonization. Upon separation of the colonies, the newly-formed United States Government took possession. Additional acquisitions resulted from treaties, purchase, conquest and cession.)

Was there an extraordinary need for railroad land grants? It was reported in Congress that "This road (UP) could never be constructed on terms applicable to ordinary roads....The question is whether we shall hold our Pacific possessions and connect the (nation)....or whether we shall abandon our Pacific possessions."[36]

Were the railroad land grants gratuitous? Declared the United States Supreme Court:[37]

> Instead of giving a gratuitous reward for something already done, the act made a proposal to the company to the effect that if the later would locate, construct, and put into operation a designated line of railroad, payments would be issued to the company confirming in it the right and title to the public lands falling within the descriptive terms of the grant....The company was at liberty to accept or reject the proposal. It accepted....and thereby the parties were brought into such contractual relations that the terms of the proposal (sic) became obligatory on both....And when, by constructing the road and putting it in operation, the company performed its part of the contract, it became entitled to performance by the Government. In other words, it earned the right to the lands described.

Two other transcontinental railroads were built and completed as a result of Federal land grants.

The Northern Pacific, which was chartered July 2, 1864, to construct a railroad between Lake Superior and Puget Sound, also approximately 1,800 miles long, was granted checkerboard sections of land on each side of its right-of-way, with the condition the railroad be completed by July 4, 1879.[38] The NP soon went into receivership, but was reorganized in 1875 and its transcontinental route was completed in 1883. At the time of the chartering of the NP, the territory over which the line was to be built was a vast wasteland, and, in the public estimation, of very little value.[39]

The Atlantic and Pacific Railroad, eying the southern route championed by Jefferson Davis, was chartered July 27, 1866, to run from Springfield, Missouri, to the Pacific.[40] The road also soon failed, and much of its original rights to further land grants west from Missouri were acquired by the Atchison, Topeka and Santa Fe Railroad.[41] (Curiously, all three points, Atchison and Topeka, KS, and Santa Fe, NM, soon came to be served by branch lines only. In fact, only because Santa Fe residents themselves built a branch line did the railroad even connect Santa Fe with the mainline at Lamy.)

Meanwhile, the Southern Pacific Railroad acquired the defunct Atlantic and Pacific's west end grant within California and began building east with hopes of meeting the Texas and Pacific Railway. Though it had no land grants east of California, the SP borrowed heavily to itself finance construction through Arizona and New Mexico. The TP's westward construction program lagged, and SP decided, instead, to link with Santa Fe to complete the third transcontinental route.

The last Federal land grant act was passed in 1871.[42] Some 70 railroads were aided by Federal land grants.[43] They represented, however, only a relatively few western and southern railroads.[44] Land grant railroads were required, under terms of the Federal grants, to transport government freight and troops at 50 percent of established rates, and mail at 80 percent of established rates. The requirement for reduced rates for freight and mail continued until rescinded by Section 321 of the Transportation Act of 1940. The requirement for reduced rates for troops and military supplies continued until October 1, 1946.[45]

Land grants to railroads are estimated to have totaled 130.4 million acres, including land granted directly to states for purposes of stimulating railroad development.[46] (See Appendix) In all, 89 separate grants were made, 17 of which were forfeited for failure to meet terms of the grant.[47] (Some railroads received more than one grant; thus the listing in the Appendix does not contain the names of 72 railroads, but rather 62 railroads.)

PUTTING A VALUE ON LAND GRANT AID

The debate over the value of land grant aid, and whether or not the railroads repaid the government for that aid, has raged for generations.

Two exhaustive Federal studies were conducted subsequent to 1940, and both concluded that the railroads had, indeed, repaid the Federal government for the value of land grant aid received.

Recall that Federal land grants totaled 130.4 million acres, and carried specific conditions that the benefiting railroads had to meet. These included:

1) Constructing the railroad proposed within strict time limits.

2) Moving government traffic at half fare and mails at reduced rates as set by the Federal government.

Recall, also, that land grants for highways, canals, and river improvements carried no such quid pro quo.

The Board of Investigation and Research, created by the Transportation Act of 1940, was instructed to study the land grant matter. The Board estimated the value of land grants, based upon net proceeds realized by the sale of the donated Federal lands, plus lands still held by the railroads, at approximately $468 million.[48] The Board first established a $126 million original value for the lands, and then assessed a five percent annual interest charge--very reasonable for that period--through June 30,

1943. And, as stated earlier, no attempt was made to measure any windfall profit received by the government in the form of higher land prices the government received from private-sector purchasers as a result of railroad construction. Also, credit was not given for railroad property taxes on railroad rights-of-way, a tax fully escaped by motor carriers and barge operators, since their rights-of-way are publicly-owned.

(While railroads, like all other corporations, paid little Federal tax until the enactment of the income tax law of 1913, railroads have, from their inception, had to deal with 168,000 separate units of government with power to assess property taxes. Later came taxes on stocks and bonds, on gross revenues and net income. Charges of major inequities in the state tax system continued through the 1970's, until the Railroad Revitalization and Regulatory Reform Act of 1976 prohibited states from taxing railroad property at rates not consistent with taxes on other commercial and industrial property: See Section 306, Public Law 93-210. The 4-R Act did not, however, remedy the fact that ad valorem taxes on rights-of-way are escaped by motor and water carriers. Ad valorem taxes amounted to more than $180 million in 1979, or about 40 percent of total railroad property taxes to state, county and municipal governments. Also, ad valorem taxes are used, in part, to build and repair municipal roads and bridges, which are utilized by railroad competitors).

The value of the lands at the time they were granted may be estimated from the price received from the sale of other Federal lands during that period.[49] The U.S. Department of Transportation, responding to Section 902 of the Railroad Revitalization and Regulatory Reform Act of 1976, made such a study that was completed in 1977. The average value of those other lands, said DOT, was 97.2 cents per acre, the same value that had been established by the Board of Investigation and Research.[50]

Robert E. Webb, Chairman of the Board of Investigation and Research, in a letter to the President and the Congress, stated that "Rate and tax compensations (those taxes paid the State of Illinois by the Illinois Central, not ad valorem property taxes) have fully counter balanced these aids which were conferred many years ago."[51] Some 138 government agencies, such as the Tennessee Valley Authority, Public Works Administration and the Federal Surplus Commodities Corp., in addition to the military, were entitled to reduced land-grant transportation rates.[52]

DOT, updating the Board's conclusions in 1977, pointed out that "...the Federal government has been a net beneficiary of its railway aid programs."[53] Not only was the Federal government reimbursed for lands it granted, but it was reimbursed at a reasonable interest rate.

Recently, the Water Transport Association charged that in exchange for reduced rates to government, the railroads exacted higher charges from private sector shippers, thereby escaping the land grant aid payback requirements.

First, it should be understood that railroad rates are assessed against commodities, not shippers. The Federal government paid 50 percent of the tariff rates assessed on specific commodities. Any increase in rates on specific commodities impacted, as well, on rates charged the government.[54] Since the private sector was the predominant rail shipper, and considerable competition between railroads existed during this period, such intramodal competition, coupled with ICC rate regulation, served to keep considerable downward pressure on freight rates.[55] Further, in 1943, the Interstate Commerce Commission itself considered a similar charge and responded that it (the ICC) had never permitted such a cross-subsidy "in fixing a reasonable rate, nor in determining whether undue prejudice exists."[56]

Most important, profit maximizing railroads would have sought--within the constraints of inter and intramodal competition and ICC rate regulation--to charge profit maximizing rates on non-government traffic regardless of any discounts required to be extended to government traffic. Realize that until the Staggers Act was passed in 1980, railroads were never subject to rate-of-return regulation. There is no basis in fact for such charges of cross-subsidization of government traffic by non-government traffic.

Finally, Congress, in 1945, in discharging the railroads from further reduced-rate obligations, stated:[57]

> ....through the years the Government has gotten all and more than it bargained for in the original land-grant transaction....the time has come for the Government to close its books on this transaction (and)....relieve the land grant railroads of the injustice of being required to continue to make payments on a debt that has long since been extinguished.

It should also be pointed out that even though early land grant railroads have been perpetuated in name, the present stockholders are not necessarily responsible for past oversights. For example, various land grants under the Pacific Railroad Acts were _not_ made to the _present_ Union Pacific Railroad Co., but rather to its predecessors, _The_ Union Pacific Railroad Co., Union Pacific Rail_way_ Co., Kansas Pacific Railway Co., and Denver Pacific Railway and Telegraph Co. As a result of financial difficulties in the 1890's, the corporate predecessors of the present Union Pacific were forced into receivership, and their properties, including their remaining grant lands and mineral reservations, were ultimately sold at a series of foreclosure sales in 1897 and 1898 to meet the debts due the Federal government and other mortgage holders.

The present Union Pacific acquired its titles and interests to the franchises, properties, and lands of these predecessor companies by purchase at foreclosure sales. Included were some 6.5 million acres of grant lands remaining unsold plus the mineral reservations on acreage previously sold.[58] Accordingly, while these may have been government grants to the predecessor companies, to the present Union Pacific Railroad Co. they are simply property which was bought and paid for in full.

As for the value of mineral deposits on grant lands, the courts have ruled that once the government issued a patent of title to lands covered by the land grant, the patent is considered final and the railroads' title to such lands is not affected by a subsequent discovery of valuable minerals.[59]

The Water Transport Association has suggested that the Federal government recompute the value of the original grant lands to take into account the current value of the natural resources contained on or under those lands. Such reasoning would suggest that if your family bought 100 acres of Texas rangeland in 1850 for $1.25 per acre, the heirs of the seller would be justified today in seeking nullification of the original sales contract simply because of oil and gas subsequently discovered. Furthermore, under such strained and unnatural reasoning, not only barge lines (which benefited from canal and river improvement land grants) would be forced to belly-up to the tax collection window to settle on the basis of today's land values, but farmers would be similarly affected. The same public policy which granted lands to railroads for development, similarly granted lands to farmers. Any law which affected grant lands and limited railroad (or their holding company's) earnings based upon resources subsequently discovered on those grant lands, would apply equally to those quarter sections granted the forebearers of today's farmers, and limit farm earnings as well. Of course the Federal courts, as explained earlier, held that once the grant lands were patented, title to the lands was not affected by a subsequent discovery of valuable minerals. And, of course, Congress, also, some 36 years ago, said it was time to "close its books" on the land grant transaction.

The Water Transport Association has also complained that non-land grant railroads shared in the repayment of the land grant debt to the Federal government. The point is irrelevant. If you borrow money from a bank, but your brother helps you repay the note, is the debt any less satisfied? The fact is that the value of railroad land grants was repaid in full by railroads, according to the Federal government. And those who quibble over which railroads repaid the land grant debt are waterways interests who have received billions of dollars in Federal subsidies but never repaid a penny of those subsidies.

Another dimension to the land grant question is provided by the recent eruption of Mt. St. Helens in Washington State. Burlington Northern, Inc., owns, as a result of Northern Pacific land grants (which were repaid in full) Mt. St. Helens, plus 41,000 acres within 16 miles of Mt. St. Helens. Should Burlington

Northern be heard to demand alternate lands or other recompense today because its one square mile on top of the mountain blew away and destroyed untold thousands of acres of other BN-owned timberland in the vicinity? Interestingly, while BN itself was financing clean-up and repair operations on its main line in Washington State as a result of the volcano eruption, Federal tax dollars were being used by the Army Corps of Engineers to reopen and dredge the Columbia and Snake River for the benefit of barge transportation. Tax dollars were also used for highway cleanup and repair.

CONCLUSION

We have seen that it was both for an access to and defense of the newly acquired western lands that forced public attention to focus on the building of transcontinental railroads. The granted lands over which the railroads were built had little value prior to the coming of the railroad, and had proved unsalable for up to 30 years previously. After the completion of the railroads, the price of the remaining lands was doubled, and the lands were soon sold.

We have also seen that land grants for inland navigation and highway development not only preceeded land grants for railroad development, but those early land grants did not carry a quid pro quo as did the railroad land grants. The railroads receiving land grants were required not only to complete their railroads within specific time limits, but they were further required to provide half fare transportation to the government for almost a century after receiving the land grants.

Two exhaustive Federal studies, one by the Board of Investigation and Research and the other by the U.S. Department of Transportation, concluded that the railroads more than repaid the value of their land grants to the Federal government. Further, the Interstate Commerce Commission ruled that the half fare provisions for government traffic did not result in the ICC allowing the railroads to prejudice non-government traffic for purposes of a cross-subsidy. The incentive for profit maximization, for an industry not subject to rate-of-return regulation, further supports this point.

Both Congress and the Federal courts have ruled that the books have been closed on the matter of past railroad land grants, and even though currently operated railroads may carry the same names as their land grant predecessors, those land grants were long ago capitalized, and as railroads were foreclosed, merged or sold, the successor companies paid in full for the value of all property acquired.

(APPENDIX)

LAND GRANT RECIPIENTS

The following railroads were recipients of land grants (includes lands granted to states to aid railroad contruction):

RAILROAD	ACRES OF LAND PATENTED *(1)*
Alabama and Chattanooga	463,253.35
Alabama and Florida	399,022.84
Atchison, Topeka and Santa Fe	2,929,348.08 *(4)*
Atlantic and Pacific	12,392,083.25 *(2)*
Bay de Noquet and Marquette	128,301.05
California and Oregon	3,239,854.05
Cedar Rapids and Missouri River	1,023,755.08
Central Pacific	7,888,617.56
Chicago, Burlington and Quincy	2,764,080.88
Chicago, Milwaukee and St. Paul	396,392.70 *(3)*
Chicago and North Western	1,073,154.66
Chicago, Rock Island and Pacific	644,747.17
Chicago, St. Paul, Minneapolis and Omaha	2,062,082.90
Dubuque and Sioux City	1,239,464.08
Flint and Pere Marquette	513,152.37
Florida and Alabama	166,691.08
Florida, Atlantic and Gulf Central	1,308,620.88
Florida Central and Peninsular	750,958.84
Grand Rapids and Indiana	846,679.45
Gulf and Ship Island	139,113.22
Hannibal and St. Joseph	611,323.35
Hastings and Dakota	374,522.55
Illinois Central	2,595,133.00
Jackson, Lansing and Saginaw	740,299.41
Kansas Pacific	7,091,647.27
Leavenworth, Lawrence and Galveston	73,893.93
Little Rock and Ft. Smith	1,052,082.51
Madison and Portage	915.38
Marquette, Houghton and Ontonagon	310,023.67
Memphis and Little Rock	188,388.95

LAND GRANTS RECIPIENTS (cont'd)

RAILROAD	ACRES OF LAND PATENTED
Minnesota and Central	176,289.78
Missouri, Kansas and Texas	609,057.63
Mobile and Girard	302,181.16
Mobile and Ohio	1,156,658.73
New Orleans Pacific	954,957.89
North Central Michigan	1,132.30
Northern Pacific	38,591,614.78
Ontonagon and Brule	34,277.08
Oregon and California	2,777,631.92
Oregon Central	128,618.13
Pacific RR of Missouri	1,161,284.51
Port Huron and Lake Michigan	37,467.44
St. Louis, Iron Mountain and Southern	1,397,426.73
St. Joseph and Denver City	486,808.87
St. Paul and Duluth	822,657.41
St. Paul and Pacific	3,256,789.82
St. Paul and Sioux City	1,126,618.55
Selma, Rome and Dalton	419,699.19
Sioux City and Pacific	41,313.83
Sioux City and St. Paul	322,412.81
Southern Minnesota	[illegible]3,470.13
South and North Alabama	522,218.75
Southern Pacific	6,789,252.60 (4)
Tennessee and Coosa	84,545.01
The Union Pacific	11,401,175.51
Vicksburg, Shreveport and Pacific	373,175.95
Vicksburg and Meridian	199,101.51
Wills Valley	240,106.45
Winona and St. Peter	1,749,209.16
Wisconsin Central	835,635.34
Wisconsin RR Farm Mortgage Co.	243,288.77
TOTAL PATENTED	130,390,692.92

LAND GRANTS RECIPIENTS (cont'd)

(1) Patented lands to which railroads earned title by right of completing construction in compliance with grant terms.

(2) The Atlantic and Pacific failed after completing 541 miles of railroad. Its original California grant was preempted by Southern Pacific, and much of its original Missouri west grant accrued to the Atchison, Topeka and Sante Fe.

(3) The Chicago, Milwaukee, and St. Paul, which later added Pacific to its name, received no land grants for its Pacific Coast Extension.

(4) See note (2), above.

FOOTNOTES

1/ Congressional Globe, 37th Congress, 1st Session, p. 1595.

2/ Michael Howard, The Franco-Prussian War (New York: Collier Books, 1969), p. 2.

3/ Mr. Justice Rehnquist, Leo Sheep Co. et. al. v. United States. Supreme Court Docket 77-1686, Decision of March 27, 1979, p. 2.

4/ "Rediscovering America," Time Magazine, July 7, 1980, p. 24.

5/ Nelson Trottman, History of the Union Pacific (New York: The Ronald Press, 1923), p. 3-4.

6/ Howard Bryan, "A Hundred Years of Railroads and Railroad Towns," New Mexico Magazine, April 1980, p. 4.

7/ D. Philip Locklin, Economics of Transportation (Homewood, IL: Richard D. Irwin, 1968), p. 3.

8/ Page Smith, The Shaping of America, Vol. 3 (New York: McGraw-Hill, 1980), p. 327.

9/ Report by the Secretary of Transportation, Study of Federal Aid to Rail Transportation, January 1977, p. III-17.

10/ Carter Goodrich, Government Promotion of American Canals and Railroads (New York: Columbia University Press, 1960), p. 38.

11/ Report by the Secretary of Transportation, op. cit., p. 111-2,4.

12/ Ibid., p. III-1.

13/ Alexander Hamilton, "Report on Manufactures 1791," as reproduced in Irwin Glusker and Richard Ketchum, editors, American Testiment (New York: American Heritage Publishing Co., 1971), p. 63.

14/ Report by the Secretary of Transportation, op. cit., p. III-25 and appendix.

15/ Charles Luna, The UTU Handbook of Transportation in America (New York: Popular Library, 1971), p. 7.

16/ Balthasar Henry Myer, editor, History of Transportation (Washington, DC: Carnegie Institution, 1917), p. 6.

17/ Dudley F. Pegrum, Transportation Economics and Public Policy (Homewood, IL: Richard D. Irwin, 1973), p. 58.

FOOTNOTES (Continued)

18/ Myer, *op. cit.*, p. 589.

19/ Thomas Donaldson, *The Public Domain* (Washington, DC: Government Printing Office, 1884), p. 257.

20/ *Ibid.*, p. 267.

21/ Horace Greeley, *An Overland Journey* (New York: Alfred Knopf, 1964), p. 310-316.

22/ Carl Sandburg, *Abraham Lincoln: The Prairie Years, Volume II* (New York: Harcourt Brace and World, 1926), p. 108.

23/ *Ibid.*, p. 108.

24/ Myer, *op. cit.*, p. 527.

25/ *Ibid.*, p. 527.

26/ Donaldson, op. cit., p. 262-264.

27/ John Bill Rae, *The Development of Railway Land Subsidy Policy in the U.S.* (New York: Arno Press, 1979), p. 15.

28/ Donaldson, *op. cit.*, p. 21.

29/ Roy J. Sampson and Martin T. Farris, *Domestic Transportation* (Boston: Houghton Mifflin, 1975), p. 29.

30/ Goodrich, *op. cit.*, p. 183.

31/ Report by the Secretary of Transportation, op. cit., p. III-6,7.

32/ Goodrich, *op. cit.*, p. 183.

33/ *Ibid*., p. 184.

34/ *Ibid*., p. 184.

35/ Report by the Secretary of Transportation, *op. cit.*, p. III-2,4.

36/ Rep. Holman, *Congressional Globe*, 37th Congress, 1st Session, p. 1912.

37/ *Burke v. Southern Pacific Railroad Co.*, 234 US 669, 680; and *Manetti v. Dillion*, 167 US 703, 721.

38/ Henry V. Poor, *Land Grants to Railroad Companies to be Recalled* (Boston: T.R. Martin and Son, 1880), p. 3.

FOOTNOTES (Continued)

39/ Ibid., p. 9-10

40/ John Bell Sanborn, "Congressional Grants of Land in Aid of Railways" in The Bulletin of the University of Wisconsin No. 30, 1899, p. 64.

41/ Goodrich, op. cit., p. 194.

42/ Board of Investigation and Research, Report on Public Aids to Domestic Transportation, September 1944, p. 109.

43/ Ibid., p. 109.

44/ Report by the Secretary of Transportation, op. cit., p. III 6-7.

45/ 59 Stat. 606.

46/ Locklin, op. cit., p. 110.

47/ Ibid., p. 108.

48/ Board of Investigation and Research, Report on Public Aids to Domestic Transportation, September 1944, p. 136.

49/ Locklin, op. cit., p. 110.

50/ Report by the Secretary of Transportation, op. cit., p. III-8; and Board of Investigation and Research, op. cit., p. 146 and p. 112.

51/ Board of Investigation and Research, op. cit., p. 7.

52/ Locklin, op. cit., p. 720.

53/ Report by the Secretary of Transportation, op. cit., p. III-2

54/ Frank N. Wilner, Competitive Equity-The Freight Railroads' Stake (Washington, DC: Association of American Railroads, 1981), p. 37.

55/ Ibid., p. 37.

56/ Monolith Portland Cement Co. v. ATSF RR Co., 255 ICC 313, 316.

57/ Discontinuance of Land Grant Rates for Transportation of Government Traffic, House Report No. 393, 79th Cong., 1st Sess., p. 3.

FOOTNOTES (Continued)

58/ Union Pacific RR Co., et al. (ICC Valuation Docket No. 1060, 44 Valuation Reports 1, 102 (1933).

59/ Burke v. Southern Pacific RR Co., 234 US 669; Thomas v. Union Pacific RR Co., 139 F. Supp. 588, 592-593, affd. 239 F. 2d 641.

secutive miles of the road mentioned in the foregoing section, in the manner provided for other roads mentioned in this act, and the act to which this is an amendment, the President of the United States shall appoint three commissioners to examine and report to him in relation thereto; and if it shall appear to him that twenty miles of said road have been completed as required by this act, then, upon certificate of said commissioner[s] to that effect, patents shall issue conveying the right and title to said lands to said company on each side of said road, as far as the same is completed, to the amount aforesaid; and such examination, report, and conveyance, by patents, shall continue from time to time, in like manner, until said road shall have been completed. And the President shall appoint said commissioners, fill vacancies in said commission, as provided in relation to other roads mentioned in the act to which this is an amendment. And the said company shall be entitled to all the privileges and immunities granted to the Hannibal and Saint Joseph's Railroad Company by the said last-mentioned act, so far as the same may be applicable: *Provided*, That no government bonds shall be issued to the said Burlington and Missouri River Railroad Company to aid in the construction of said extension of its road: *And provided, further*, That said extension shall be completed within the period of ten years from the passage of this act.

Patents to issue.

Provisos.

Sec. 21. *And be it further enacted*, That before any land granted by this act shall be conveyed to any company or party entitled thereto under this act, there shall first be paid into the treasury of the United States, the cost of surveying, selecting, and conveying the same, by the said company or party in interest, as the titles shall be required by said company, which amount shall, without any further appropriation, stand to the credit of the proper account, to be used by the commissioner of the general land-office for the prosecution of the survey of the public lands along the line of said road, and so from year to year until the whole shall be completed, as provided under the provisions of this act.

Cost of surveying, &c., to be paid before conveyances are made.

Amended

24:142,

38:474, 1035

39:104

Sec. 22. *And be it further enacted*, That congress may, at any time, alter, amend, or repeal this act.

This act may be altered, &c.

Approved, July 2, 1864.

Chap. CCXVII. — *An Act granting Lands to aid in the Construction of a Railroad and Telegraph Line from Lake Superior to Puget's Sound, on the Pacific Coast, by the Northern Route.*

July 2, 1864.

Pub. 186

HR 483

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That Richard D. Rice, John A. Poore, Samuel P. Strickland, Samuel C. Fessenden, Charles P. Kimball, Augustine Haines, Edwin R. W. Wiggin, Anson P. Morrill, Samuel J. Anderson, of Maine; Willard Sears, I. S. Withington, Josiah Perham, James M. Becket, A. W. Banfield, Abiel Abbott, John Newell, Austin L. Rogers, Nathaniel Greene, jnr., Oliver Frost, John A. Bass, John O. Bresbrey, George Shiverick, Edward Tyler, Filander J. Forristall, Ivory H. Pope, of Massachusetts; George Opdyke, Fairley Holmes, John Huggins, Philander Reed, George Briggs, Chauncy Vibbard, John C. Fremont, of New York; Ephraim Marsh, John P. Jackson, jr., of New Jersey; S. M. Felton, John Toy, O. J. Dickey, B. F. Archer, G. W. Cass, J. Edgar Thompson, John A. Green, of Pennsylvania; T. M. Allyn, Moses W. Wilson, Horace Whittaker, Ira Bliss, of Connecticut; Joseph A. Gilmore, Onslow Stearns, E. P. Emerson, Frederick Smyth, William E. Chandler, of New Hampshire; Cyrus Aldrich, H. M. Rice, John McKusick, H. C. Waite, Stephen Miller, of Minnesota; E. A. Chapin, John Gregory Smith, George Merrill, of Vermont; James Y. Smith, William S. Slater, Isaac H. Southwick, Earl P. Mason, of Rhode Island; Seth Fuller, William Kellogg, U. S. Grant, William B. Ogden, William G. Greene, Leonard Sweat, Henry W. Blodgett, Porter Sheldon, of Illinois; J. M. Winchell, Elsworth Cheesebrough, James S. Emery, of Kansas; Richard

Northern Pacific Railroad Company incorporated.

Names of corporators.

Northern Pacific Railroad Company.

Powers, &c.

F. Perkins, Richard Chenery, Samuel Brannan, George Rowland, Henry Platt, of California; William F. Mercer, James W. Brownley, of Virginia; John H. B. Latrobe, W. Prescott Smith, of Maryland; Greenbury Slack, A. J. Boreman, of West Virginia; Thomas E. Bramlette, Frank Shorin, of Kentucky; John Brough, John A. Bingham, Oran Follett, John Gardner, S. S. L'Hommedieu, Harrison G. Blake, Philo Chamberlin, of Ohio; John A. Duncan, Samuel M. Harrington, of Delaware; Thomas A. Morris, Jesse L. Williams, of Indiana; Samuel L. Case, Henry L. Hall, David H. Jerome, Thomas D. Gilbert, C. A. Trowbridge, of Michigan; Edward H. Broadhead, Alexander Mitchell, Benjamin Ferguson, Levi Sterling, —— Marshal, of Wisconsin; J. C. Ainsworth, Orlando Humason, H. W. Corbett, Henry Failling, of Oregon; J. B. S. Todd, M. K. Armstrong, J. Shaw Gregory, J. Le Berge, of Dakota Territory; John Mullan, Anson G. Henry, S. D. Smith, Charles Terry, of Washington Territory; H. W. Starr, Platt Smith, Nixon Denton, William Leighton, B. F. Allen, Reuben Noble, John L. Davies, of Iowa; Willard P. Hall, George R. Smith, H. Gayle King, John C. Sargeant, of Missouri; William H. Wallace, of Idaho Territory; J. H. Lathrop, Henry D. Cooke, H. E. Merrick, of the District of Columbia, and all such other persons who shall or may be associated with them, and their successors, are hereby created and erected into a body corporate and politic, in deed and in law, by the name, style, and title of the "Northern Pacific Railroad Company," and by that name shall have perpetual succession, and shall be able to sue and to be sued, plead and be impleaded, defend and be defended, in all courts of law and equity within the United States, and may make and have a common seal.

May lay out, &c., a railroad and telegraph line.

And said corporation is hereby authorized and empowered to lay out, locate, construct, furnish, maintain, and enjoy a continuous railroad and telegraph line, with the appurtenances, namely, beginning at a point on Lake Superior, in the State of Minnesota or Wisconsin; thence westerly by the most eligible railroad route, as shall be determined by said company, within the territory of the United States, on a line north of the forty-fifth degree of latitude to some point on Puget's Sound, with a branch, via the valley of the Columbia River, to a point at or near Portland, in the State of Oregon, leaving the main trunk-line at the most suitable place, not more than three hundred miles from its western terminus; and is hereby vested with all the powers, privileges, and immunities necessary to carry into effect the purposes of this act as herein set forth.

Capital stock.

The capital stock of said company shall consist of one million shares of one hundred dollars each, which shall in all respects be deemed personal property, and shall be transferable in such manner as the by-laws of said corporation shall provide.

Commissioners.

Quorum.

The persons hereinbefore named are hereby appointed commissioners, and shall be called the board of commissioners of the "Northern Pacific Railroad Company," and fifteen shall constitu[t]e a quorum for the transaction of business.

First meeting of commissioners.

The first meeting of said board of commissioners shall be held at the Melodion hall, in the city of Boston, at such time as any five commissioners herein named from Massachusetts shall appoint, not more than three months after the passage of this act, notice of which shall be given by them to the other commissioners by publishing said notice in at least one daily newspaper in the cities of Boston, New York, Philadelphia, Cincinnati, Milwaukee, and Chicago, once a week at least four weeks previous to the day of meeting.

Officers, &c.

Said board shall organize by the choice from its number of a president, vice-president, secretary, and treasurer, and they shall require from said treasurer such bonds as may be deemed proper, and may from time to time increase the amount thereof as they may deem proper. The secretary shall be sworn to the faithful performance of his duties, and such oath shall be entered upon the records of the company, signed by him, and the oath verified thereon. The president and secretary of said board shall in like manner call all

Meetings.

Books of subscription.

First meeting of subscribers to stock.

Directors.

Inspectors of election.

Commissioners to deliver to directors.

Annual meetings.

other meetings, naming the time and place thereof. It shall be the duty of said board of commissioners to open books, or cause books to be opened, at such times, and in such principal cities or other places in the United States, as they, or a quorum of them, shall determine, within six months after the passage of this act, to receive subscriptions to the capital stock of said corporation, and a cash payment of ten per centum on all subscriptions, and to receipt therefor. So soon as twenty thousand shares shall in good faith be subscribed for, and ten dollars per share actually paid into the treasury of the company, the said president and secretary of said board of commissioners shall appoint a time and place for the first meeting of the subscribers to the stock of said company, and shall give notice thereof in at least one newspaper in each state in which subscription books have been opened, at least fifteen days previous to *to* the day of meeting, and such subscribers as shall attend the meeting so called, either in person or by lawful proxy, then and there shall elect by ballot thirteen directors for said corporation; and in such election each share of said capital stock shall entitle the owner thereof to one vote. The president and secretary of the board of commissioners, and, in case of their absence or inability, any two of the officers of said board, shall act as inspectors of said election, and shall certify under their hands the names of the directors elected at said meeting; and the said commissioners, treasurer, and secretary, shall then deliver over to said directors all the properties, subscription books, and other books in their possession, and thereupon the duties of said commissioners, and the officers previously appointed by them, shall cease and determine forever, and thereafter the stockholders shall constitute said body politic and corporate. Annual meetings of the stockholders of the said corporation for the choice of officers (when they are to be chosen) and for the transaction of business shall be holden at such time and place and upon such notice as may be proscribed in the by-laws.

Right of way.

Materials for construction.

Indian titles to be extinguished.

Sec. 2. *And be it further enacted*, That the right of way through the public lands be, and the same is hereby, granted to said "Northern Pacific Railroad Company," its successors and assigns, for the construction of a railroad and telegraph as proposed; and the right, power, and authority is hereby given to said corporation to take from the public lands, adjacent to the line of said road, material of earth, stone, timber, and so forth, for the construction thereof. Said way is granted to said railroad to the extent of two hundred feet in width on each side of said railroad where it may pass through the public domain, including all necessary ground for station buildings, workshops, depots, machine shops, switches, side tracks, turn-tables, and water-stations; and the right of way shall be exempt from taxation within the territories of the United States. The United States shall extinguish, as rapidly as may be consistent with public policy and the welfare of the said Indians, the Indian titles to all lands falling under the operation of this act, and acquired in the donation to the [road] named in this bill.

Grant of public lands.

see 46: 41c

Sec. 3. *And be it further enacted*, That there be, and hereby is, granted to the "Northern Pacific Railroad Company," its successors and assigns, for the purpose of aiding in the construction of said railroad and telegraph line to the Pacific coast, and to secure the safe and speedy transportation of the mails, troops, munitions of war, and public stores, over the route of said line of railway, every alternate section of public land, not mineral, designated by odd numbers, to the amount of twenty alternate sections per mile, on each side of said railroad line, as said company may adopt, through the territories of the United States, and ten alternate sections of land per mile on each side of said railroad whenever it passes through any state, and whenever on the line thereof, the United States have full title, not reserved, sold, granted, or otherwise appropriated, and free from preëmption, or other claims or rights, at the time the line of said road is definitely fixed, and a plat thereof filed in the office and within 50 miles thereof

Lands in lieu of those reserved, &c.

Proviso.

Mineral lands excluded.

of the commissioner of the general land-office; and whenever, prior to said time, any of said sections or parts of sections shall have been granted, sold, reserved, occupied by homestead settlers, or preëmpted, or otherwise disposed of, other lands shall be selected by said company in lieu thereof, under the direction of the Secretary of the Interior, in alternate sections, and designated by odd numbers, not more than ten miles beyond the limits of said alternate sections: *Provided*, That if said route shall be found upon the line of any other railroad route to aid in the construction of which lands have been heretofore granted by the United States, as far as the routes are upon the same general line, the amount of land heretofore granted shall be deducted from the amount granted by this act: *Provided, further*, That the railroad company receiving the previous grant of land may assign their interest to said "Northern Pacific Railroad Company," or may consolidate, confederate, and associate with said company upon the terms named in the first section of this act: *Provided, further*, That all mineral lands be, and the same are hereby, excluded from the operations of this act, and in lieu thereof a like quantity of unoccupied and unappropriated agricultural lands, in odd numbered sections, nearest to the line of said road, may be selected as above provided: *And provided, further*, That the word "mineral," when it occurs in this act, shall not be held to include iron or coal: *And provided, further*, That no money shall be drawn from the treasury of the United States to aid in the construction of the said "Northern Pacific Railroad."

Commissioners.

Patents.

Proviso.

Sec. 4. *And be it further enacted*, That whenever said "Northern Pacific Railroad Company" shall have twenty-five consecutive miles of any portion of said railroad and telegraph line ready for the service contemplated, the President of the United States shall appoint three commissioners to examine the same, and if it shall appear that twenty-five consecutive miles of said road and telegraph line have been completed in a good, substantial, and workmanlike manner, as in all other respects required by this act, the commissioners shall so report to the President of the United States, and patents of lands, as aforesaid, shall be issued to said company, confirming to said company the right and title to said lands, situated opposite to, and coterminous with, said completed section of said road; and, from time to time, whenever twenty-five additional consecutive miles shall have been constructed, completed, and in readiness as aforesaid, and verified by said commissioners to the President of the United States, then patents shall be issued to said company conveying the additional sections of land as aforesaid, and so on as fast as every twenty-five miles of said road is completed as aforesaid: *Provided*, That not more than ten sections of land per mile, as said road shall be completed, shall be conveyed to said company for all that part of said railroad lying east of the western boundary of the State of Minnesota, until the whole of said railroad shall be finished and in good running order, as a first-class railroad, from the place of beginning on Lake Superior to the western boundary of Minnesota: *Provided, also*, That lands shall not be granted under the provisions of this act on account of any railroad, or part thereof, constructed at the date of the passage of this act.

Railroad to be constructed in, &c.

Gauge.

Telegraph line.

Sec. 5. *And be it further enacted*, That said Northern Pacific Railroad shall be constructed in a substantial and workmanlike manner, with all the necessary draws, culverts, bridges, viaducts, crossings, turnouts, stations, and watering places, and all other appurtenances, including furniture, and rolling stock, equal in all respects to railroads of the first class, when prepared for business, with rails of the best quality, manufactured from American iron. And a uniform gauge shall be established throughout the entire length of the road. And there shall be constructed a telegraph line, of the most substantial and approved description, to be operated along the entire line: *Provided*, That the said company shall not charge the government higher rates than they do individuals for like transportation and telegraphic service. And it shall be the duty of the Northern Pacific Railroad Company to permit any other railroad which shall be authorized to be built by the United States, or by the legislature of any territory or state in which the same may be situated, to form running connections with it, on fair and equitable terms.

Other roads may form connections.

Lands on both sides of road to be surveyed, &c.

Sec. 6. *And be it further enacted*, That the President of the United States shall cause the lands to be surveyed for forty miles in width on both sides of the entire line of said road, after the general route shall be fixed, and as fast as may be required by the construction of said railroad; and the odd sections of land hereby granted shall not be liable to sale, or entry, or preëmption before or after they are surveyed, except by said company, as provided in this act; but the provisions of the act of September, eighteen hundred and forty-one, granting preëmption rights, and the acts amendatory thereof, and of the act entitled "An act to secure homesteads to actual settlers on the public domain," approved May twenty, eighteen hundred and sixty-two, shall be, and the same are hereby, extended to all other lands on the line of said road, when surveyed, excepting those hereby granted to said company. And the reserved alternate sections shall not be sold by the government at a price less than two dollars and fifty cents per acre, when offered for sale.

1841, ch. 16, Vol. v. p. 453.

1862, ch. 75, Vol. xii. p. 392.

Company may take lands necessary for its road.

Sec. 7. *And be it further enacted*, That the said "Northern Pacific Railroad Company" be, and is hereby, authorized and empowered to enter upon, purchase, take, and hold any lands or premises that may be necessary and proper for the construction and working of said road, not exceeding in width two hundred feet on each side of the line of its railroad, unless a greater width be required for the purpose of excavation or embankment; and also any lands or premises that may be necessary and proper for turnouts, standing places for cars, depots, station-houses, or any other structures required in the construction and working of said road. And the said company shall have the right to cut and remove trees and other material that might, by falling, encumber its road-bed, though standing or being more than two hundred feet from the line of said road. And in case the owner of such lands or premises and the said company cannot agree as to the value of the premises taken, or to be taken, for the use of said road, the value thereof shall be determined by the appraisal of three disinterested commissioners, who may be appointed, upon application by either party, to any court of record in any of the territories in which the lands or premises to be taken lie; and said commissioners, in their assessment of damages, shall appraise such premises at what would have been the value thereof if the road had not been built. And upon return into court of such appraisement, and upon the payment into the same of the estimated value of the premises taken for the use and benefit of the owner thereof, said premises shall be deemed to be taken by said company, which shall thereby acquire full title to the same for the purposes aforesaid. And either party feeling aggrieved at said appraisement may, within thirty days after the same has been returned into court, file an appeal therefrom, and demand a jury of twelve men to estimate the damage sustained; but such appeal shall not interfere with the rights of said company to enter upon the premises taken, or to do any act necessary and proper in the construction of its road. And said party appealing shall give bonds, with sufficient surety or sureties, for the payment of any cost that may arise upon such appeal; and in case the party appealing does not obtain a verdict, increasing or diminishing, as the case may be, the award of the commissioners, such party shall pay the whole cost incurred by the appellee, as well as his own, and the payment into court, for the use of the owner of said premises taken, of a sum equal to that finally awarded, shall be held to vest in said company the title of said land, and of the right to use and occupy the same for the construction, maintenance, and operation of said road. And in case any

Damages, how determined.

Appeal from assessment.

Lands held by infants or persons under any legal disability.

of the lands to be taken, as aforesaid, shall be held by any infant, femme covert, non compos, insane person, or persons residing without the territory within which the lands to be taken lie, or persons subjected to any legal disability, the court may appoint a guardian for any party under any disqualification, to appear in proper person, who shall give bonds, with sufficient surety or sureties, for the proper and faithful execution of his trust, and who may represent in court the person disqualified, as aforesaid, from appearing, when the same proceedings shall be had in reference to the appraisement of the premises to be taken for the use of said company, and with the same effect as has been already described; and the title of the company to the lands taken by virtue of this act shall not be affected or impaired by reason of any failure by any guardian to discharge faithfully his trust. And in case any party shall have a right or claim to any land for a term of years, or any interest therein, in possession, reversion, or remainder, the value of any such estate, less than a fee simple, shall be estimated and determined in the manner hereinbefore set forth. And in case it shall be necessary for the company to enter upon any lands which are unoccupied, and of which there is no apparent owner or claimant, it may proceed to take and use the same for the purposes of said railroad, and may institute proceedings, in manner described, for the purpose of ascertaining the value of, and of acquiring title to, the same; but the judge of the court hearing said suit shall determine the kind of notice to be served on such owner or owners, and he may in its discretion appoint an agent or guardian to represent such owner or owners in case of his or their incapacity or non-appearance. But in case no claimant shall appear within six years from the time of the opening of said road across any land, all claims to damages against said company shall be barred.

Claims to be made within six years.

Conditions of grant.

amended

15:755

SEC. 8. *And be it further enacted*, That each and every grant, right, and privilege herein are so made and given to, and accepted by, said Northern Pacific Railroad Company, upon and subject to the following conditions, namely: That the said company shall commence the work on said road within two years from the approval of this act by the President, and shall complete not less than fifty miles per year after the second year, and shall construct, equip, furnish, and complete the whole road by the fourth day of July, anno Domini eighteen hundred and seventy-six.

If company breaks conditions, &c., the United States may complete the road.

SEC. 9. *And be it further enacted*, That the United States make the several conditioned grants herein, and that the said Northern Pacific Railroad Company accept the same, upon the further condition that if the said company make any breach of the conditions hereof, and allow the same to continue for upwards of one year, then, in such case, at any time hereafter, the United States, by its congress, may do any and all acts and things which may be needful and necessary to insure a speedy completion of the said road.

Any person may subscribe to stock.

per 15:346

No mortgage unless, &c.

SEC. 10. *And be it further enacted*, That all people of the United States shall have the right to subscribe to the stock of the Northern Pacific Railroad Company until the whole capital named in this act of incorporation is taken up, by complying with the terms of subscription; and no mortgage or construction bonds shall ever be issued by said company on said road, or mortgage, or lien made in any way, except by the consent of the congress of the United States.

Railroad to be post route and military road.

SEC. 11. *And be it further enacted*, That said Northern Pacific Railroad, or any part thereof, shall be a post route and a military road, subject to the use of the United States, for postal, military, naval, and all other government service, and also subject to such regulations as congress may impose restricting the charges for such government transportation.

Company to signify in writing its acceptance of terms, &c., of grant.

SEC. 12. *And be it further enacted*, That the acceptance of the terms, conditions, and impositions of this act by the said Northern Pacific Railroad Company shall be signified in writing under the corporate seal of said company, duly executed pursuant to the direction of its board of directors first had and obtained, which acceptance shall be made within two years after the passage of this act, and not afterwards, and shall be served on the President of the United States.

Annual report of directors.

Sec. 13. *And be it further enacted*, That the directors of said company shall make an annual report of their proceedings and expenditures, verified by the affidavits of the president and at least six of the directors, and they shall, from time to time, fix, determine, and regulate the fares, tolls, and charges to be received and paid for transportation of persons and property on said road, or any part thereof.

President and other officers.

Sec. 14. *And be it further enacted*, That the directors chosen in pursuance of the first section of this act shall, so soon as may be after their election, elect from their own number a president and vice-president; and said board of directors shall, from time to time, and so soon as may be after their election, choose a treasurer and secretary, who shall hold their offices at the will and pleasure of the board of directors. The treasurer and secretary shall give such bonds, with such security as the said board from time to time may require. The secretary shall, before entering upon his duty, be sworn to the faithful discharge thereof, and said oath shall be made a matter of record upon the books of said corporation. No person shall be a director of said company unless he shall be a stockholder, and qualified to vote for directors at the election at which he shall be chosen.

Term of office of president and other officers.

Quorum.

By-laws.

Power of directors.

Sec. 15. *And be it further enacted*, That the president, vice-president, and directors shall hold their offices for the period indicated in the by-laws of said company, not exceeding three years, respectively, and until others are chosen in their place, and qualified. In case it shall so happen that an election of directors shall not be made on any day appointed by the by-laws of said company, the corporation shall not for that excuse be deemed to be dissolved, but such election may be holden on any day which shall be appointed by the directors. The directors, of whom seven, including the president, shall be a quorum for the transaction of business, shall have full power to make and prescribe such by-laws, rules, and regulations as they shall deem needful and proper touching the disposition and management of the stock, property, estate, and effects of the company, the transfer of shares, the duties and conduct of their officers and servants touching the election and meeting of the directors, and all matters whatsoever which may appertain to the concerns of said company; and the said board of directors may have full power to fill any vacancy or vacancies that may occur from any cause or causes from time to time in their said board. And the said board of directors shall have power to appoint such engineers, agents, and subordinates as may from time to time be necessary to carry into effect the object of the company, and to do all acts and things touching the location and construction of said road.

Payment of each assessment.

Notice.

Stock to be forfeited, &c.

Sec. 16. *And be it further enacted*, That it shall be lawful for the directors of said company to require payment of the sum of ten per centum each assessment upon all subscriptions received of all subscribers, and the balance thereof at such times and in such proportions and on such conditions as they shall deem to be necessary to complete the said road and telegraph line within the time in this act prescribed. Sixty days' previous notice shall be given of the payments required, and of the time and place of payment, by publishing a notice once a week in one daily newspaper in each of the cities of Boston, New York, Philadelphia, and Chicago; and in case any stockholder shall neglect or refuse to pay, in pursuance of such notice, the stock held by such person shall be forfeited absolutely to the use of the company, and also any payment or payments that shall have been made on account thereof, subject to the condition that the board of directors may allow the redemption on such terms as they may prescribe.

Company may accept, &c., grants.

Sec. 17. *And be it further enacted*, That the said company is authorized to accept to its own use any grant, donation, loan, power, franchise, aid, or assistance which may be granted to, or conferred upon, said company by the congress of the United States, by the legislature of any state, or by any corporation, person, or persons; and said corporation is authorized to hold and enjoy any such grant, donation, loan, power, franchise, aid, or assistance, to its own use for the purpose aforesaid.

Company to gain consent of state legislatures, &c.

Sec. 18. *And be it further enacted*, That said Northern Pacific Railroad Company shall obtain the consent of the legislature of any state through which any portion of said railroad line may pass, previous to commencing the construction thereof; but said company may have the right to put on engineers and survey the route before obtaining the consent of the legislature.

Act to be void, unless, &c.

Sec. 19. *And be it further enacted*, That unless said Northern Pacific Railroad Company shall obtain bonâ fide subscriptions to the stock of said company to the amount of two millions of dollars, with ten per centum paid within two years after the passage and approval of this act, it shall be null and void.

Act may be altered, &c.

Sec. 20. *And be it further enacted*, That the better to accomplish the object of this act, namely, to promote the public interest and welfare by the construction of said railroad and telegraph line, and keeping the same in working order, and to secure to the government at all times (but particularly in time of war) the use and benefits of the same for postal, military, and other purposes, congress may, at any time, having due regard for the rights of said Northern Pacific Railroad Company, add to, alter, amend, or repeal this act.

Approved, July 2, 1864.

July 2, 1864.

Chap. CCXVIII. — *An Act to quiet the Titles to Lands within the Rancho Laguna de Santos Callé, in the State of California.*

Temporary

Titles to lands in the Rancho Laguna de Santos Calle, California, quieted.

Pub. 187
41-557

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That it may and shall be lawful for all purchasers from the grantees or their assigns of lands within the Rancho Laguna de Santos Callé, in the State of California, to file, within twelve months from the passage of this act, with the register of the land-office at Marysville, applications describing the lands so purchased by them respectively, with proofs of bonâ fide purchase from the said grantees or their assigns; and, upon such proofs being found satisfactory, the said purchasers shall be permitted to enter, according to the lines of the public surveys, at one dollar and twenty-five cents per acre, the lands so purchased within the limits of said rancho, as described in the petition presented to the board of commissioners under the act of March 3, 1851, entitled "An act to ascertain and settle the private land claims in the State of California," to the extent to which the lands so purchased have been reduced to possession, and are now held by said purchasers: *Provided*, That any person who shall avail himself of the provisions of this act shall be thereafter debarred any further claim under the grantee in the event of a final confirmation of the grant.

1851, ch. 41. Vol. ix. p. 631.

Costs of additional surveys.

Sec. 2. *And be it further enacted*, That where any additional surveys may be found necessary to give full effect to this act, the commissioner of the general land-office shall cause such surveys to be made at the cost of the purchasers, as provided by the 10th section of the act of May 30th, 1862, entitled "An act to reduce the expenses of the survey and sale of the public lands of the United States:" *Provided*, That no entry of mineral lands or lands reserved for military or other public uses, shall be permitted under this act, nor shall any rights acquired under the preemption laws of the United States be affected hereby.

1862, ch. 86, § 10. Vol. xii. p. 410.

Proviso.

Sec. 3. *And be it further enacted*, That it shall be the duty of the land and on the sea, the rebellion has been crushed and its pride and its power have been humbled, by whose fidelity to the cause of freedom the government of the people has been preserved and maintained, and by whose orderly return from the fire and blood of civil war to the peaceful pursuits of private life the exalting and ennobling influence of free institutions upon a nation has been so signally manifested to the world.

officers, soldiers, and seamen of the United States

APPROVED, May 3, 1866.

[No. 34.] *A Resolution extending the Time for the Completion of the Union Pacific Railway, Eastern Division.*

May 7, 1866.

Temporary

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the time for the completion of the first one hundred miles of railroad and telegraph line by the Leavenworth, Pawnee, and Western Railroad Company, (since called the "Union Pacific Railway Company, eastern division,") mentioned in the tenth section of the charter of the Union Pacific Railroad Company, of July first, one thousand eight hundred and sixty-two, and in the fifth section of the amendment thereof, of July second, one thousand eight hundred and sixty-four, be, and the same is hereby, extended until the twenty-seventh day of June, one thousand eight hundred and sixty-six; and that the time for completing each succeeding section of one hundred miles shall be reckoned from the said twenty-seventh day of June in said year.

Time for completing the eastern division of the Union Pacific Railway extended.
1862, ch. 120.
Vol. xii. p. 489.
1865, ch. 216, § 5.
Vol. xiii. p. 359

Succeeding sections.

SEC. 2. *And be it further resolved*, That the time for commencing and completing the Northern Pacific Railroad, and all its several sections, is extended for the term of two years.

Northern Pacific Railroad.

APPROVED, May 7, 1866.

[No. 35.] *Joint Resolution to provide for the Exemption of Crude Petroleum from Internal Tax or Duty, and for other Purposes.*

May 9, 1866.

Be it resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That paraffine oil, not exceeding in specific gravity thirty-six degrees Baumé's hydrometer, the product of a residuum of distillation; crude petroleum; and crude oil, the product of the first and single distillation of coal, shale, asphaltum, peat, or other bituminous substances, shall, from and after the passage of this joint resolution, be exempt from internal tax or duty.

Crude petroleum, &c. to be exempt from internal tax.

APPROVED, May 9, 1866.

[No. 37.] *Joint Resolution relative to the attempted Assassination of the Emperor of Russia.*

May 16, 1866.

Temporary

Be it resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the Congress of the United States of America has learned with deep regret of the attempt made upon the life of the Emperor of Russia, by an enemy of emancipation. The Congress sends greeting to his Imperial Majesty, and to the Russian nation, and congratulates the twenty millions of serfs upon the providential escape from danger of the sovereign, to whose head and heart they owe the blessings of their freedom.

Congratulations of Congress that the Emperor of Russia escaped assassination.

SEC. 2. *And be it further resolved*, That the President of the United States be requested to forward a copy of this resolution to the Emperor of Russia.

President requested to forward copy.

APPROVED, May 16, 1866.

15 Stat. 255 (1868)

Wright," of St. John, New Brunswick, a gold chronometer, in token of appreciation by the government of the United States of his humane and successful efforts in rescuing from death three American seamen on board of the wreck of the American schooner "Lizzie F. Choate," of Gloucester, Massachusetts, wrecked at sea on the fourteenth of February, eighteen hundred and sixty-eight.

Approved, June 25, 1868.

[No. 42.] *Joint Resolution to authorize the Secretary of War to place at the Disposal of the Lincoln Monument Association damaged and captured Ordnance.*

June 25, 1868.

Pur. Res. 30
J Res 21

Temporary

Certain damaged and captured ordnance to be given to the Lincoln Monument Association.

1867, ch. 18. *Ante*, p. 11.

Be it resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the Secretary of War be, and he is hereby, authorized, at his discretion, to place at the disposal of the "Lincoln Monument Association," incorporated by an act of Congress entitled "An act to incorporate the Lincoln Monument Association," approved March thirtieth, eighteen hundred and sixty-seven, such damaged and captured bronze and brass guns and ordnance, out of which to cast the statues of the principal figures surmounting and to be incorporated in said structure: *Provided*, That no metal as aforesaid shall be thus appropriated until the voluntary contributions for said purpose, actually in the hands of the treasurer, shall amount to one hundred thousand dollars; and no more metal shall be thus appropriated than shall be actually used for the purpose of casting the figures as herein mentioned.

Proviso.

Approved, June 25, 1868.

[No. 43.] *Joint Resolution donating to the Washington City Orphan Asylum the Iron Railing taken from the old Hall of the House of Representatives.*

June 25, 1868.

Pur. Res 35
J Res

Temporary

Iron railing given to Washington City Orphan Asylum.

Be it resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That there be donated to the Washington City Orphan Asylum the iron railing taken from the old hall of the House of Representatives, now in the Capitol grounds: *Provided*, That the same shall be taken away in ten days after the passage of this joint resolution.

Proviso.

Approved, June 25, 1868.

[No. 47.] *Joint Resolution extending the Time for the Completion of the Northern Pacific Railroad.*

July 1, 1868.

Pur. Res. 3
J Res. 3

[illegible]

Time for completing Northern Pacific Railroad extended.

1864, ch. 217, § 8. Vol. xiii. p. 370.

Be it resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That section eight of an act entitled "An act granting lands to aid in the construction of a railroad and telegraph line from Lake Superior to Puget Sound, on the Pacific coast," is hereby so amended as to read as follows: That each and every grant, right, and privilege herein, are so made and given to and accepted by said Northern Pacific Railroad Company upon and subject to the following conditions, namely: That the said company shall commence the work on said road within two years from and after the second day of July, eighteen hundred and sixty-eight, and shall complete not less than one hundred miles per year after the second year thereafter, and shall construct, equip, furnish, and complete the whole road by the fourth day of July, Anno Domini eighteen hundred and seventy-seven.

Approved, July 1, 1868.

Ryan-Hitchcock mode of marine fortifications to be inquired into, and report made to Congress.

the admiral of the navy, or in the absence of the admiral, then the vice-admiral, be authorized and directed to inquire into the utility and practicability of the Ryan-Hitchcock mode of marine fortifications, and that they report to Congress at the next session thereof.

Approved, February 19, 1869.

Feb. 27, 1869.

Pur Res 10

[No. 14.] *A Resolution proposing an Amendment to the Constitution of the United States.*

Fifteenth amendment to the Constitution.

S. Res 5

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, (two thirds of both houses concurring,) That the following article be proposed to the legislatures of the several States as an amendment to the Constitution of the United States, which, when ratified by three fourths of said legislatures, shall be valid as part of the Constitution, namely:

Article XV.

Section 1. The right of citizens of the United States to vote shall not be denied or abridged by the United States or by any State on account of race, color, or previous condition of servitude.

Sec. 2. The Congress shall have power to enforce this article by appropriate legislation.

SCHUYLER COLFAX,
Speaker of the House of Representatives.
B. F. WADE,
President of the Senate pro tempore.

Attest:
Edwd. McPherson,
Clerk of House of Representatives.
Geo. C. Gorham,
Sec'y of Senate U. S.

Received at Department of State February 27, 1869.

Pur Res 11

March 1, 1869.
1864, ch. 217, § 10.
Vol. xiii. p. 370.

H Res 458

[No. 15.] *Joint Resolution gra[n]ting the Consent of Congress provided for in section ten of the Act incorporating the Northern Pacific Railroad Company, approved July second, eighteen hundred and sixty-four.*

Consent of Congress given to the Northern Pacific R. R. Co. to issue bonds, &c.

Be it resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the consent of the Congress of the United States is hereby given to the Northern Pacific Railroad Company to issue its bonds, and to secure the same by mortgage upon its railroad and its telegraph line, for the purpose of raising funds with which to construct said railroad and telegraph line between Lake Superior and Puget Sound, and also upon its branch to a point at or near Portland, Oregon; and the term "Puget Sound," as used here and in the act incorporating said company, is hereby construed to mean all the waters connected with the straits of Juan de Fuca within the territory of the United States.

Approved, March 1, 1869.

Pur. Res 12

March 1, 1869.

Temporary

H Res 460

[No. 16.] *Joint Resolution in Relation to the Meeting of the House of Representatives at the first Session of the Forty-first Congress.*

Time of first regular meeting of the House of Representatives of the 41st Congress.

Be it resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the time for the first regular meeting of the House of Representatives of the Forty-first Congress be, and is hereby, postponed from twelve o'clock meridian, on the fourth day of March, eighteen hundred and sixty-nine, to the hour of three o'clock in the afternoon of the said day.

Approved, March 1, 1869.

tives, to be retained until captives are given up.

until said captives shall be surrendered to the lawful authorities of the United States.

J. G. BLAINE,
Speaker of the House of Representatives.
SCHUYLER COLFAX,
Vice-President of the United States and President of the Senate.

Received by the President May 4, 1870.

[Note by the Department of State. — The foregoing resolution having been presented to the President of the United States for his approval, and not having been returned by him to the House of Congress in which it originated within the time prescribed by the Constitution of the United States, has become a law without his approval.]

May 23, 1870.

[No. 63.] *A Resolution authorizing the Secretary of War to place at the Disposal of the Commissioners of Quarantine, or other proper Authorities of the State of New York, the Steamer "Illinois," for Quarantine Purposes.*

The steamer "Illinois" placed at the disposal of the commissioners of quarantine, &c. New York.

Pub. Res. No. 16.
Vol. xiv. p. 351.

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the Secretary of War is hereby authorized, in his discretion, to place gratuitously, for an indefinite period, at the disposal of the commissioners of quarantine or the proper authorities of the State of New York, to be used for quarantine purposes, the steamer "Illinois," which said steamer was turned over to the quarantine commissioners under authority of joint resolution of March *twenty-one* [twenty-four], eighteen hundred [and] sixty-six, and has ever since been in their possession.

Approved, May 23, 1870.

May 27, 1870.

[No. 66.] *A Resolution to provide for the Appointment of an Examiner of Claims for the Department of State, and for additional Clerks in the Department.*

Examiner of claims authorized for the Department of State.

Appointment, salary, &c.

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That there shall be appointed by the President of the United States, by and with the advice and consent of the Senate, a suitable person learned in the law, to be called the examiner of claims for the Department of State, who shall receive the annual salary of three thousand five hundred dollars.

Additional clerks for Secretary of State.

Appropriation.

Sec. 2. *And be it further resolved,* That the Secretary of State be, and hereby is, authorized to employ three additional clerks for indexing the books, papers, and documents of the department; two of them to be clerks of the fourth class, and the other of the third class; and for the payment of such examiner and clerks, and for the compensation of extra and temporary clerks, whose employment may be necessary, the sum of seven thousand five hundred dollars is hereby appropriated.

Approved, May 27, 1870.

May 31, 1870.

[No. 67.] *A Resolution authorizing the Northern Pacific Railroad Company to issue its Bonds for the Construction of its Road and to secure the same by Mortgage, and for other Purposes.*

Northern Pacific Railroad Company may issue bonds secured by mortgage.

Mortgage to be filed, &c. in &c. as proof of its execution.

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the Northern Pacific Railroad Company be, and hereby is, authorized to issue its bonds to aid in the construction and equipment of its road, and to secure the same by mortgage on its property and rights of property of all kinds and descriptions, real, personal, and mixed, including its franchise as a corporation; and, as proof and notice of its legal execution and effectual delivery, said mortgage shall be filed and recorded in the office of the Secretary of the Interior; and also to locate and construct, under the provisions and with the privileges, grants, and duties provided for in its act of incorporation,

Location of road, &c.
1864, ch. 217.
Vol. xiii. p. 365.

Deficiency in lands how may be made up.

Twenty-five miles of road to be completed by January 1, 1872, and forty miles each year thereafter.
1864, ch. 217, § 8.
Vol. xiii. p. 370.
Pub. Res. No. 34.
Vol. xiv. p. 355.
Pub. Res. No. 47.
Vol. xv. p. 255.

Lands unsold, &c. after five years from completion of road to be subject to settlement and pre-emption at not over $ 2.50 per acre.

Proviso in case of foreclosure.

American iron or steel made, &c. to be used exclusively.

its main road to some point on Puget Sound, via the valley of the Columbia river, with the right to locate and construct its branch from some convenient point on its main trunk line across the Cascade Mountains to Puget Sound; and in the event of there not being in any State or Territory in which said main line or branch may be located, at the time of the final location thereof, the amount of lands per mile granted by Congress to said company, within the limits prescribed by its charter, then said company shall be entitled, under the directions of the Secretary of the Interior, to receive so many sections of land belonging to the United States, and designated by odd numbers, in such State or Territory, within ten miles on each side of said road, beyond the limits prescribed in said charter, as will make up such deficiency, on said main line or branch, except mineral and other lands as excepted in the charter of said company of eighteen hundred and sixty-four, to the amount of the lands that have been granted, sold, reserved, occupied by homestead settlers, pre-empted, or otherwise disposed of subsequent to the passage of the act of July two, eighteen hundred and sixty-four. And that twenty-five miles of said main line between its western terminus and the city of Portland, in the State of Oregon, shall be completed by the first day of January, anno Domini eighteen hundred and seventy-two, and forty miles of the remaining portion thereof each year thereafter, until the whole shall be completed between said points: *Provided*, that all lands hereby granted to said company which shall not be sold or disposed of or remain subject to the mortgage by this act authorized, at the expiration of five years after the completion of the entire road, shall be subject to settlement and pre-emption like other lands, at a price to be paid to said company not exceeding two dollars and fifty cents per acre; and if the mortgage hereby authorized shall at any time be enforced by foreclosure or other legal proceeding, or the mortgaged lands hereby granted, or any of them, be sold by the trustees to whom such mortgage may be executed, either at its maturity or for any failure or default of said company under the terms thereof, such lands shall be sold at public sale, at places within the States and Territories in which they shall be situate, after not less than sixty days' previous notice, in single sections or subdivisions thereof, to the highest and best bidder: *Provided further*, That in the construction of the said railroad, American iron or steel only shall be used, the same to be manufactured from American ores exclusively.

Resolution may be altered, &c.

SEC. 2. *And be it further resolved*, That Congress may at any time alter or amend this joint resolution, having due regard to the rights of said company, and any other parties.

APPROVED, May 31, 1870.

June 6, 1870.

[No. 69.] *Joint Resolution to correct an Error in the Enrolment of a joint Resolution therein named.*

Byers Street, Springfield, Mass., to be a public highway.
Pub. Res. No. 41.
Ante, p. 374.

Be it resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the second section of the joint resolution "authorizing the sale of certain lands at Springfield, Massachusetts, and for other purposes," approved May fourth, eighteen hundred and seventy, be so amended that it will read, "That Byers Street, heretofore opened," &c., instead of "Ryers Street," as it was erroneously enrolled.

APPROVED, June 6, 1870.

June 7, 1870.

[No. 70.] *A Resolution to authorize the Secretary of the Treasury to issue an American Register to the Bark "Live Oak" and to the Ship "Agra" of Boston.*

American register to issue to the bark

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the Secretary of the Treasury be, and he is hereby, authorized and directed to issue an Ameri-

Inspection, etc.

Sec. 2. That the Secretary of the Treasury be, and hereby is, authorized and directed to authorize and direct the inspection of said steam-vessel, steam-boiler, steam-pipes, and the appurtenances of said boiler, and cause to be granted the proper and usual certificate issued to steam-vessels of the merchant marine, without reference to the fact that said steam-boiler, steam-pipes, and appurtenances were not constructed pursuant to the laws of the United States, and were not constructed of iron stamped pursuant to said laws; and the tests to be applied in the inspection of said boiler, steam-pipes, and appurtenances will be the same in all respects as to strength and safety as are required in the inspection of boilers constructed in the United States for marine purposes, save the fact that said boiler, steam-pipes, and appurtenances not being constructed pursuant to the requirements of the laws of the United States, and are of unstamped iron, shall not be an obstacle to the granting of the usual certificate if said boiler, steam-pipes, and appurtenances are found to be of sufficient strength and safety.

Approved, September 27, 1890.

Pub. No. 300 S. 2781

September 29, 1890.

CHAP. 1040—An act to forfeit certain lands heretofore granted for the purpose of aiding in the construction of railroads, and for other purposes.

Forfeiture of unearned lands granted to railroads in any State, etc.

Forfeiture and resumption.

Code 43:904

Restored to public domain.

Proviso.

Rights of way, etc.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That there is hereby forfeited to the United States, and the United States hereby resumes the title thereto, all lands heretofore granted to any State or to any corporation to aid in the construction of a railroad opposite to and coterminous with the portion of any such railroad not now completed, and in operation, for the construction or benefit of which such lands were granted; and all such lands are declared to be a part of the public domain: *Provided*, That this act shall not be construed as forfeiting the right of way or station grounds of any railroad company heretofore granted.

Preference rights of present actual settlers to enter.

Temporary

Time limit.

Entry for time of actual occupation.

Second homestead entries.

Code 43:905

Rules.

Sec. 2. That all persons who, at the date of the passage of this act, are actual settlers in good faith on any of the lands hereby forfeited and are otherwise qualified, on making due claim on said lands under the homestead law within six months after the passage of this act, shall be entitled to a preference right to enter the same under the provisions of the homestead law and this act, and shall be regarded as such actual settlers from the date of actual settlement or occupation; and any person who has not heretofore had the benefit of the homestead or pre-emption law, or who has failed from any cause to perfect the title to a tract of land heretofore entered by him under either of said laws, may make a second homestead entry under the provisions of this act. The Secretary of the Interior shall make such rules as will secure to such actual settlers these rights.

Purchasers, etc., in possession.

Temporary

Amended

t 29:535c

Code 43:906

Settlers intending to purchase.

Entitled to purchase.

Limitations.

Sec. 3. That in all cases where persons being citizens of the United States, or who have declared their intentions to become such, in accordance with the naturalization laws of the United States, are in possession of any of the lands affected by any such grant and hereby resumed by and restored to the United States, under deed, written contract with, or license from, the State or corporation to which such grant was made, or its assignees, executed prior to January first, eighteen hundred and eighty-eight, or where persons may have settled said lands with bona fide intent to secure title thereto by purchase from the State or corporation when earned by compliance with the conditions or requirements of the granting acts of Congress, they shall be entitled to purchase the same from the United States, in quantities not exceeding three hundred and twenty acres to any one such person, at the rate of one dollar and twenty-five cents per acre, at any time within two years from the passage of this act, and on making said payment to receive patents therefor, and where any such person in actual possession of any such lands and having improved the same prior to the first day of January, eighteen hundred and ninety, under deed, written contract, or license as aforesaid, or his assignor, has made partial or full payments to said railroad company prior to said date, on account of the purchase price of said lands from it, on proof of the amount of such payments he shall be entitled to have the same, to the extent and amount of one dollar and twenty-five cents per acre, if so much has been paid, and not more, credited to him on account of and as part of the purchase price herein provided to be paid the United States for said lands, or such persons may elect to abandon their purchases and make claim on said lands under the homestead law and as provided in the preceding section of this act: *Provided*, That in all cases where parties, persons, or corporations, with the permission of such State or corporation, or its assignees, are in the possession of and have made improvements upon any of the lands hereby resumed and restored, and are not entitled to enter the same under the provisions of this act, such parties, persons, or corporations shall have six months in which to remove any growing crop, and within which time they shall also be entitled to remove all buildings and other movable improvements from said lands: *Provided further*, That the provisions of this section shall not apply to any lands situate in the State of Iowa on which any person in good faith has made or asserted the right to make a pre-emption or homestead settlement: *And provided further*, That nothing in this act contained shall be construed as limiting the rights granted to purchasers or settlers by "An act to provide for the adjustment of land grants made by Congress to aid in the construction of railroads and for the forfeiture of unearned lands, and for other purposes," approved March third, eighteen hundred and eighty-seven, or as repealing, altering, or amending said act, nor as in any manner affecting any cause of action existing in favor of any purchaser against his grantor for breach of any covenants of title.

Patents to issue.

Purchasers, etc., in possession, having improved.

Proof of payments.

Credit on account.

Optional abandonment, etc.

Provisos.

Certain parties in possession may remove crops and improvements.

Certain lands in Iowa exempted.

Rights of certain purchasers, etc., not limited.

Vol. 24, pp. 556-558.

SEC. 4. That section five of an act entitled "An act for a grant of lands to the State of Iowa in alternate sections to aid in the construction of a railroad in said State," approved May seventeenth, eighteen hundred and sixty-four, and section seven of an act entitled "An act extending the time for the completion of certain land-grant railroads in the States of Minnesota and Iowa, and for other purposes," approved March third, eighteen hundred and sixty-five, and also section five of an act entitled "An act making an additional grant of lands to the State of Minnesota in alternate sections to aid in the construction of railroads in said State," approved July fourth, eighteen hundred and sixty-six, so far as said sections are applicable to lands embraced within the indemnity limits of said grants, be, and the same are hereby, repealed; and so much of the provisions of section four of an act approved June second, eighteen hundred and sixty-four, and entitled "An act to amend an act entitled 'An act making a grant of lands to the State of Iowa in alternate sections to aid in the construction of certain railroads in said State,'" approved May fifteenth, eighteen hundred and fifty-six, be, and the same are hereby, repealed so far as they require the Secretary of the Interior to reserve any lands but the odd sections within the primary or six miles granted limits of the roads mentioned in said act of June second, eighteen hundred and sixty-four, or the act of which the same is amendatory.

Withdrawals within certain indemnity limits, Iowa and Minnesota.

Vol. 13, p. 74, repealed.

Vol. 13, p. 527, repealed.

Vol. 14, p. 88, repealed.

Reservation of certain lands, Iowa.

Vol. 13, p. 95, repealed.

Vol. 10, p. 9.

local

Special

SEC. 5. That if it shall be found that any lands heretofore granted to the Northern Pacific Railroad Company and so resumed by the United States and restored to the public domain lie north of the line

Northern Pacific Railroad lands, north of "Harrison's line."

local

partly

Temporary

Persons in possession, etc., may purchase, without limit of quantity.

Time limit.

Rate.

Patents upon proof.

Proviso.

Confirmation of forfeited rights of way, etc., to Portland, Oregon.

known as the "Harrison line," being a line drawn from Wallula, Washington, easterly to the southeast corner of the northeast one-fourth of the southeast quarter of section twenty-seven, in township seven north, of range thirty-seven east, of the Willamette meridian, all persons who had acquired in good faith the title of the Northern Pacific Railroad Company to any portion of said lands prior to July first, eighteen hundred and eighty-five, or who at said date were in possession of any portion of said lands or had improved the same, claiming the same under written contract with said company, executed in good faith, or their heirs or assigns, as the case may be, shall be entitled to purchase the lands so acquired, possessed, or improved, from the United States, at any time prior to the expiration of one year after it shall be finally determined that such lands are restored to the public domain by the provisions of this act, at the rate of two dollars and fifty cents per acre, and to receive patents therefor upon proof before the proper land office of the fact of such acquisition, possession, or improvement, and payment therefor, without limitation as to quantity: *Provided*, That the rights of way and riparian rights heretofore attempted to be conveyed to the city of Portland, in the State of Oregon, by the Northern Pacific Railroad Company and the Central Trust Company of New York, by deed of conveyance dated August eighth, eighteen hundred and eighty-six, and which are described as follows: A strip of land fifty feet in width, being twenty-five feet on each side of the center line of a water-pipe line, as the same is staked out and located, or as it shall be hereafter finally located according to the provisions of an act of the legislative assembly of the State of Oregon approved November twenty-fifth, eighteen hundred and eighty-five, providing for the means to supply the city of Portland with an abundance of good, pure, and wholesome water over and across the following described tracts of land: Sections nineteen and thirty-one in township one south, of range six east; sections twenty-five, thirty-one, thirty-three, and thirty-five, in township one south, of range five east; sections three and five in township two south, of range five east; section one in township two south, of range four east; sections twenty-three, twenty-five, and thirty-five in township one south, of range four east, of the Willamette meridian, in the State of Oregon, forfeited by this act, are hereby confirmed unto the said city of Portland, in the State of Oregon, its successors and assigns forever, with the right to enter on the hereinbefore-described strip of land, over and across the above-described sections for the purpose of constructing, maintaining, and repairing a water-pipe line aforesaid.

Disposition of forfeited lands, etc.

43:907

SEC. 6. That no lands declared forfeited to the United States by this act shall by reason of such forfeiture inure to the benefit of any State or corporation to which lands may have been granted by Congress, except as herein otherwise provided; nor shall this act be construed to enlarge the area of land originally covered by any such grant, or to confer any right upon any State, corporation or person to lands which were excepted from such grant. Nor shall the moiety of the lands granted to any railroad company on account of a main and a branch line appertaining to uncompleted road, and hereby forfeited, within the conflicting limits of the grants for such main and branch lines, when but one of such lines has been completed, inure by virtue of the forfeiture hereby declared, to the benefit of the completed line.

Confirmation of Gulf and Ship Island, Miss., lands, to cash purchasers, and certain other claimants.

Temporary

SEC. 7. That in all cases where lands included in a grant of land to the State of Mississippi, for the purpose of aiding in the construction of a railroad from Brandon to the Gulf of Mexico, commonly known as the Gulf and Ship Island Railroad, have heretofore been sold by the officers of the United States for cash, or with the allowance or approval of such officers have been entered in good faith under the pre-emption or homestead laws, or upon which there were bona fide pre-emption or homestead claims on the first day of January, eighteen hundred and ninety, arising or asserted by actual occupation of the land under color of the laws of the United States, the right and title of the persons holding or claiming any such lands under such sales or entries are hereby confirmed and persons claiming the right to enter as aforesaid may perfect their entry under the law. And on condition that the Gulf and Ship Island Railroad Company within ninety days from the passage of this act shall, by resolution of its board of directors, duly accept the provisions of the same and file with the Secretary of the Interior a valid relinquishment of all said company's interest, right, title, and claim in and to all such lands as have been sold, entered, or claimed as aforesaid, then the forfeiture declared in the first section of this act shall not apply to or in anywise affect so much and such parts of said grant of lands to the State of Mississippi as lie south of a line drawn east and west through the point where the Gulf and Ship Island Railroad may cross the New Orleans and Northeastern Railroad in said State, until one year after the passage of this act. And there may be selected and certified to or in behalf of said company lands in lieu of those hereinbefore required to be surrendered to be taken within the indemnity limits of the original grant nearest to and opposite such part of the line as may be constructed at the date of selection.

Forfeiture not to apply to certain lands, on condition.

Relinquishment of title, etc.

Lieu lands may be selected, etc.

Sec. 8. That the Mobile and Girard Railroad Company, of Alabama, shall be entitled to the quantity of land earned by the construction of its road from Girard to Troy, a distance of eighty-four miles. And the Secretary of the Interior in making settlement and certifying to or for the benefit of the said company the lands earned thereby shall include therein all the lands sold, conveyed or otherwise disposed of by said company not to exceed the total amount earned by said company as aforesaid. And the title of the purchasers to all such lands are hereby confirmed so far as the United States are concerned.

Confirmation of earned lands to Mobile and Girard Railroad Company, Ala.

Settlement and certification.

Title of purchasers.

But such settlement and certification shall not include any lands upon which there were bona fide pre-emptors or homestead claims on the first day of January, eighteen hundred and ninety, arising or asserted by actual occupation of the land under color of the laws of the United States.

Pre-emption and homestead claims.

The right hereby given to the said railroad company is on condition that it shall within ninety days from the passage of this act, by resolution of its board of directors, duly accept the provisions of the same and file with the Secretary of the Interior a valid relinquishment of all said company's interest, right, title, and claim in and to all such lands within the limits of its grant, as have heretofore been sold by the officers of the United States for cash, where the Government still retains the purchase money, or with the allowance or approval of such officers have been entered in good faith under the pre-emption or homestead laws, or as are claimed under the homestead or pre-emption laws as aforesaid, and the right and title of the persons holding or claiming any such lands under such sales or entries are hereby confirmed, and all such claims under the pre-emption or homestead laws may be perfected as provided by law. Said company to have the right to select other lands, as near as practicable to constructed road, and within indemnity limits in lieu of the lands so relinquished. And the title of the United States is hereby relinquished in favor of all persons holding under any sales by the local land officers, of the lands in the granted limits of the Alabama and Florida Railroad grant, where the United States still retains the purchase money but without liability on the part of the United States.

Confirmation conditioned on acceptance, etc.

Relinquishment of title, etc., to certain lands.

Confirmation to certain claimants.

Perfection of claims.

Lieu lands may be selected.

Relinquishment of Government title to certain purchasers of Alabama and Florida Railroad lands.

Approved, September 29, 1890.

Total limit to a State or Territory.

for the purpose of discharging the obligations created hereunder in any State or Territory: *Provided further*, That the total expenditures on account of any State or Territory shall at no time exceed its authorized apportionment.

Rural post roads.

Cooperating with States in constructing.

Vol. 39, p. 355.

Vol. 40, p. 1201.

Vol. 42, p. 666.

Provisos.

Immediate apportionment to be made.

Approval of project by Secretary deemed a Federal obligation.

Cooperative Construction of the Federal Aid Highway System: For carrying out the provisions of the Act entitled "An Act to provide that the United States shall aid the States in the construction of rural post roads, and for other purposes," approved July 11, 1916, and all Acts amendatory thereof and supplementary thereto, to be expended in accordance with the provisions of said Act as amended, $13,000,000, to be available until expended, being part of the sum of $75,000.000 authorized to be appropriated for the fiscal year ending June 30, 1925, by paragraph 1 of section 4 of the Act making appropriations for the Post Office Department for the fiscal year 1923, approved June 19, 1922: *Provided*, That the Secretary of Agriculture is hereby authorized, immediately upon the passage of this Act, to apportion among the several States, as provided in section 21 of the Federal Highway Act, approved November 9, 1921, the sum of $75,000,000 authorized to be appropriated for the fiscal year ending June 30, 1925, by said paragraph 1 of section 4 of the Act approved June 19, 1922: *Provided further*, That the Secretary of Agriculture shall act upon projects submitted to him under his apportionment of this authorization, and his approval of any such project within three years shall be deemed a contractual obligation of the Federal Government for the payment of its proportional contribution thereto.

Total, Department of Agriculture, $58,575,274.

Approved, June 5, 1924.

June 5, 1924.
[H. J. Res. 237.]
[Pub. Res., No. 24.]

Private

Temporary

CHAP. 267.—Joint Resolution Directing the Secretary of the Interior to withhold his approval of the adjustment of the Northern Pacific land grants, and for other purposes.

Northern Pacific land grants.

Approval of adjustment of, by Secretary of the Interior, to be withheld, etc., until March 4, 1926.

Amended

44: 1405

45: 789a,

Vol. 13, p. 365; Vol. 16, p. 378.

Provisos.

Regular public land entries not affected.

Inhibition to end March 4, 1926, unless proceedings pending in courts for adjudication by direction of Congress.

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the Secretary of the Interior is hereby directed to withhold until March 4, 1926, his approval of the adjustment of the Northern Pacific land grants under the Act of July 2, 1864, and the joint resolution of May 31, 1870, and he is also hereby directed to withhold the issuance of any further patents and muniments of title under the said Act and the said resolution or any legislative enactments supplemental thereto or connected therewith, until after Congress shall have made a full and complete inquiry into the said land grants and the Acts supplemental thereto for the purpose of considering legislation to meet the respective rights of the Northern Pacific Railroad Company and its successors and the United States in the premises: *Provided*, That this Act shall not prevent the adjudication of any claims arising under the public land laws where the claimants are not seeking title through the grants to the Northern Pacific Railroad Company, or its successors, or any Acts in modification thereof, or supplemental thereto: *Provided further*, That the inhibition against the approval of said land grants and the issuance of patents and muniments of title thereunder shall unless further extended terminate on March 4, 1926, unless on said date said land grants and the proceedings thereunder are being adjudicated at the direction of Congress in the courts, in which event the approval of said land grants and the issuance of patents and muniments of title shall await the final adjudication thereof.

Congress to be advised of status of grants, etc., by Secretary of the Interior.

Sec. 2. The Secretary of the Interior is hereby directed to advise Congress of the status of the said Northern Pacific land grants, recommending such action as he believes right and proper for the further adjustment thereof.

Joint Congressional Committee created to investigate the grants, to the Company.

Vol. 13, p. 365; Vol. 16, p. 378.

Conclusions and recommendations to be reported.

Powers conferred to sit, take testimony, etc.

Issue of subpœnas.

Assistance of courts.

Failure to obey court order, punishable as contempt of court.

Punishment for refusing to testify, etc.

Sec. 3. That a joint committee of both Houses of Congress is hereby created to be composed of five Members of the Senate to be appointed by the President thereof, and five Members of the House of Representatives to be appointed by the Speaker of that body. Any vacancy occurring on the committee shall be filled in the same manner as the original appointment. The said committee is hereby empowered and directed to make a thorough and complete investigation of the land grants of the Northern Pacific Railroad Company, and its successor, the Northern Pacific Railway Company, under the Act of July 2, 1864 (Thirteenth Statutes, page 365), and the joint resolution of May 31, 1870 (Sixteenth Statutes, page 378), and any other Acts of Congress supplemental thereto or connected therewith, and the facts and the law pertaining thereto and arising therefrom, and to report to Congress its conclusions and recommendations based thereon. Said committee or any subcommittee thereof is hereby empowered to sit and act during the session or recess of Congress or of either House thereof in the District of Columbia or elsewhere in the United States; to require by subpœna or otherwise the attendance of witnesses and the production of books, documents, and papers; to take the testimony of witnesses under oath; to obtain documents, papers, and other information from the several departments of the Government or any bureau thereof; to employ stenographers to take and to make a record of all evidence taken and received by the committee and to keep a record of its proceedings; to have such evidence, record, and other matter required by the committee printed and suitably bound; and to employ such assistance as may be deemed necessary. The chairman of the committee or any member thereof may administer oaths to witnesses. Subpœnas for witnesses shall be issued under the signature of the chairman of the committee or the chairman of any subcommittee thereof. And in case of disobedience to a subpœna this committee may invoke the aid of any court of the United States or of the District of Columbia within the jurisdiction of which any inquiry may be carried on by said committee in requiring the attendance and testimony of witnesses, and the production of books, papers, and documents under the provisions of this resolution. And any such court within the jurisdiction of which the inquiry under this resolution is being carried on may in case of contumacy or refusal to obey a subpœna issued on any person under authority of this resolution issue an order requiring such person to appear before said committee and produce books and papers, if so ordered, and give evidence touching the matter in question, and any failure to obey such order of the court may be punished by such court as a contempt thereof. Every person who, having been summoned as a witness by authority of said committee or any subcommittee thereof, willfully makes default, or who having appeared refuses to answer any question pertinent to the investigation herein authorized, shall be deemed guilty of a misdemeanor and upon conviction thereof be punished by a fine of not more than $1,000 and imprisonment for not more than one year.

Amount for expenses authorized to be appropriated.
Post, pp. 673, 1314.

The sum of $50,000, or so much thereof as may be necessary, is hereby authorized to be appropriated, out of any money in the Treasury not otherwise appropriated, to pay the necessary expenses of said joint committee, the sum to be disbursed by the secretary of the committee upon vouchers to be approved by the chairman of the committee.

Approved, June 5, 1924.

CHAP. 39.—An Act To authorize and direct a survey to be made of the Escambia River and its tributaries, Alabama and Florida.

June 24, 1929.
[H. R. 2671.]
[Public, No. 20.]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Secretary of War be, and he is hereby, authorized and directed to cause a survey to be made of the Escambia River and its tributaries, Alabama and Florida, with a view to the control of floods in accordance with the provisions of section 3 of an Act entitled, "An Act to provide for control of the floods of the Mississippi River, and of the Sacramento River, California, and for other purposes," approved March 1, 1917, the cost thereof to be paid from appropriations heretofore or hereafter made for such purposes.

Escambia River, etc., Ala. and Fla.
Survey directed for controlling floods of.
Vol. 39, p. 950.

Approved, June 24, 1929.

CHAP. 40.—An Act To amend subdivision (a) of section 1 of the Act entitled "An Act making it a felony with penalty for certain aliens to enter the United States of America under certain conditions in violation of law," approved March 4, 1929.

June 24, 1929.
[S. 1537.]
[Public, No. 21.]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subdivision (a) of section 1 of the Act entitled "An Act making it a felony with penalty for certain aliens to enter the United States of America under certain conditions in violation of law," approved March 4, 1929 (Public Law Numbered 1018, Seventieth Congress), is amended to read as follows:

Immigration.
Vol. 45, p. 1551, amended.

"That (a) if any alien has been arrested and deported in pursuance of law, he shall be excluded from admission to the United States whether such deportation took place before or after the enactment of this Act, and if he enters or attempts to enter the United States after the expiration of sixty days after the enactment of this Act he shall be guilty of a felony and upon conviction thereof shall, unless a different penalty is otherwise expressly provided by law, be punished by imprisonment for not more than two years or by a fine of not more than $1,000, or by both such fine and imprisonment: *Provided*, That this Act shall not apply to any alien arrested and deported before March 4, 1929, in pursuance of law, in whose case prior to his reembarkation at a place outside the United States, or his application in foreign contiguous territory for admission to the United States, and prior to March 4, 1929, the Secretary of Labor has granted such alien permission to reapply for admission."

Deported alien attempting to reenter, guilty of a felony.

Punishment for.

Proviso.
Not applicable if permission granted to apply for admission prior to March 4, 1929.

Approved, June 24, 1929.

CHAP. 41.—An Act To alter and amend an Act entitled "An Act granting lands to aid in the construction of a railroad and telegraph line from Lake Superior to Puget Sound, on the Pacific Coast, by the northern route," approved July 2, 1864, and to alter and amend a joint resolution entitled "Joint resolution authorizing the Northern Pacific Railroad Company to issue its bonds for the construction of its road and to secure the same by mortgage, and for other purposes," approved May 31, 1870; to declare forfeited to the United States certain claimed rights asserted by the Northern Pacific Railroad Company, or the Northern Pacific Railway Company; to direct the institution and prosecution of proceedings looking to the adjustment of the grant, and for other purposes.

June 25, 1929.
[S. 609.]
[Public, No. 22.]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That any and all lands within the indemnity limits of the land grants made by Congress to the Northern Pacific Railroad Company under the Act of July 2, 1864, and the resolution of May 31, 1870, which, on June 5, 1924, were embraced within the exterior boundaries of any national forest or other Government reservation and which, in the event of

Northern Pacific Railroad land grants.
Public lands within indemnity selection of, embraced in national forests, etc., removed from selection by the railroad, and retained by the United States.
Vol. 13, p. 367; Vol. 16, p. 378.

Proviso.
Compensation for the lands retained.

a deficiency in the said land grants to the Northern Pacific Railroad Company upon the dates of the withdrawals of the said indemnity lands for governmental purposes, would be, or were, available to the Northern Pacific Railroad Company or its successor, the Northern Pacific Railway Company, by indemnity selection or otherwise in satisfaction of such deficiency in said land grants, are hereby taken out of and removed from the operation of the said land grants, and are hereby retained by the United States as part and parcel of the Government reservations wherein they are situate, relieved and freed from all claims, if any exist, which the Northern Pacific Railroad Company or its successor, the Northern Pacific Railway Company, may have to acquire the said lands by indemnity selection or otherwise in satisfaction of the said land grants: *Provided*, That for any or all of the aforesaid indemnity lands hereby retained by the United States under this Act the Northern Pacific Railroad Company or its successor, the Northern Pacific Railway Company, or any subsidiary of either or both, or any subsidiary of a subsidiary of either or both, shall be entitled to and shall receive compensation from the United States to the extent and in the amounts, if any, the courts hold that compensation is due from the United States.

Unsatisfied indemnity selection rights claimed, hereby forfeited.

Vol. 13, p. 365; vol. 16, p. 379.

Sec. 2. That all of the unsatisfied indemnity selection rights, if any exist, claimed by the Northern Pacific Railroad Company or its successor, the Northern Pacific Railway Company, or any subsidiary of either or both, or any subsidiary of a subsidiary of either or both, or by any grantee or assignee of either or both, together with all claims to additional lands under and by virtue of the land grants contained in the Act of July 2, 1864, and resolution of May 31, 1870, or any other Acts of Congress supplemental or relating thereto, are hereby declared forfeited to the United States.

Reserved rights under former laws continued.

Policy as to disposition of granted lands not departed from.

Further legislation authorized.

Sec. 3. The rights reserved to the United States in the Act of July 2, 1864, to add to, alter, amend, or repeal said Act, and in the resolution of May 31, 1870, to alter or amend said resolution, are not to be considered as fully exercised, waived, or destroyed by this Act or the exercise of the authority conferred hereby; and the passage of this Act shall not be construed as in anywise evidencing the purpose or intention of Congress to depart from the policy of the United States expressed in the resolution of May 31, 1870, relative to the disposition of granted lands by said grantee, and the right is hereby reserved to the United States to, at any time, enact further legislation relating thereto.

Railroad right of way, etc., not affected.

Sec. 4. The provisions of this Act shall not be construed as affecting the present title of the Northern Pacific Railroad Company or its successors, the Northern Pacific Railway Company, or any subsidiary of either or both, in the right of way of said road or lands actually used in good faith by the Northern Pacific Railway Company in the operation of said road.

Institution of proceedings to judicially determine all controversies respecting said grants, etc.

Sec. 5. The Attorney General is hereby authorized and directed forthwith to institute and prosecute such suit, or suits, as may, in his judgment, be required to remove the cloud cast upon the title to lands belonging to the United States as a result of the claim of said companies, and to have all said controversies and disputes respecting the operation and effect of said grants, and actions taken under them, judicially determined, and a full accounting had between the United States and said companies, and a determination made of the extent, if any, to which the said companies, or either of them, may be entitled to have patented to them additional lands of the United States in satisfaction of said grants, and as to whether either of the said companies is lawfully entitled to all or any part of the lands within the indemnity limits for which patents have not issued, and the extent to which the United States may be entitled to

Consideration, etc., of all questions of law and facts, all germane claims, etc.

Foreclosure of mortgage by the railroad, etc.

Erroneously patented lands, etc.

Rights of United States and the companies to be completely adjudicated.

Vol. 43, p. 461.

recover lands wrongfully patented or certified. In the judicial proceedings contemplated by this Act there shall be presented, and the court or courts shall consider, make findings relating to, and determine to what extent the terms, conditions, and covenants, expressed or implied, in said granting Acts have been performed by the United States, and by the Northern Pacific Railroad Company, or its successors, including the legal effect of the foreclosure of any and all mortgages which said Northern Pacific Railroad Company claims to have placed on said granted lands by virtue of authority conferred in the said resolution of May 31, 1870, and the extent to which said proceedings and foreclosures meet the requirements of said resolution with respect to the disposition of said granted lands, and relative to what lands, if any, have been wrongfully or erroneously patented or certified to said companies, or either of them, as the result of fraud, mistake of law or fact, or through legislative or administrative misapprehension as to the proper construction of said grants or Acts supplemental or relating thereto, or otherwise, and the United States and the Northern Pacific Railroad Company, or the Northern Pacific Railway Company, or any other proper person, shall be entitled to have heard and determined by the court all questions of law and fact, and all other claims and matters which may be germane to a full and complete adjudication of the respective rights of the United States and said companies, or their successors in interest under said Act of July 2, 1864, and said joint resolution of May 31, 1870, and in other Acts or resolutions supplemental thereto, and all other questions of law and fact presented to the joint congressional committee appointed under authority of the joint resolution of Congress of June 5, 1924 (Forty-third Statutes, page 461), notwithstanding that such matters may not be specifically mentioned in this enactment. //

All unearned lands received by the railroad to be fully accounted for, by court decrees.

Fixing of amount to companies for indemnity lands within national forests, etc., retained by the United States.

Sec. 6. All lands received by the Northern Pacific Railroad Company or its successors, the Northern Pacific Railway Company, under said grants or Acts of Congress supplemental or relating thereto which have not been earned, but which have been, for any reason, erroneously credited or patented to either of said companies, or its, or their, successors, shall be fully accounted for by said companies, either by restitution of the land itself, where the said lands have not passed into the hands of innocent purchasers for value, or otherwise, in accordance with the findings and decrees of the courts. In fixing the amount, if any, the said companies are entitled to receive on account of the retention by the United States of indemnity lands within national forests and other Government reservations, as by this enactment provided, the court shall determine the full value of the interest which may be rightfully claimed by said companies, or either of them, in said lands under the terms of said grants, and shall determine what quantities in lands or values said companies have received in excess of the full amounts they were entitled to receive, either as a result of breaches of the terms, conditions, or covenants, either expressed or implied, of said granting Acts by said companies, or either of them, or through mistake of law or fact, or through misapprehension as to the proper construction of said grants, or as a result of fraud, or otherwise, and said excess lands and values, if any, shall be charged against said companies in the judgments and decrees of said court. To carry out this enactment the court may render such judgments and decrees as law and equity may require.

Venue of actions in district courts.

Sec. 7. The suit, or suits, herein authorized shall be brought in a district court of the United States for some district within the States of Wisconsin, Minnesota, North Dakota, Montana, Idaho, Washington, or Oregon, and may be consolidated with any other actions now pending between the same parties in the same court involving the

Persons having interest in the lands, made parties.

Service of writs.

Appeals.

Review by Supreme Court.

Expedition of hearings.

Authority for appropriate legislation and appropriations.

subject matter, and any such court shall in any such suit have jurisdiction to hear and determine all matters and things submitted to it in pursuance of the provisions of this Act, and in any such suit brought by the Attorney General hereunder any persons having an interest in or lien upon any lands included in the lands claimed by the United States, or by said companies, or any interest in the proceeds or avails thereof may be made parties. On filing the complaint in such cause, writs of subpœna may be issued by the court against any parties defendant, which writs shall run into any districts and shall be served, as any other like process, by the respective marshals of such districts. The judgment, or judgments, which may be rendered in said district court shall be subject to review on appeal by the United States circuit court of appeals for the circuit which includes the district in which the suit is brought, and the judgment, or judgments, of such United States circuit court of appeals shall be reviewable by the Supreme Court of the United States, as in other cases. Any case begun in accordance with this Act shall be expedited in every way, and be assigned for hearing at the earliest practicable day in any court in which it may be pending. Congress shall be given a reasonable time, which shall be fixed by the court, within which it may enact such legislation and apppropriate such sums of money as may be necessary to meet the requirements of any final judgment resulting by reason of the litigation herein provided for.

Final determinations to be reported to Congress with recommendations of desirable legislation.

Sec. 8. It shall be the duty of the Attorney General to report to the Congress of the United States any final determinations rendered in such suit or proceedings, and the Attorney General, the Secretary of the Interior, and the Secretary of Agriculture shall thereafter submit to Congress recommendations for the enactment of such legislation, if any, as may be deemed by them to be desirable in the interests of the United States in connection with the execution of said decree or otherwise.

Approval of adjustments of Northern Pacific land grants to be withheld.

No further patents to be issued until suits be finally determined.

Proviso.
Other land claims not affected.

Sec. 9. That the Secretary of the Interior is hereby directed to withhold his approval of the adjustment of the Northern Pacific land grants under the Act of July 2, 1864, and the joint resolution of May 31, 1870, and other Acts relating thereto; and he is also hereby directed to withhold the issuance of any further patents and muniments of title under said Act and the said resolution, or any legislative enactments supplemental thereto, or connected therewith, until the suit or suits contemplated by this Act shall have been finally determined: *Provided*, That this Act shall not prevent the adjudication of any claims arising under the public land laws where the claimants are not seeking title through the grants to the Northern Pacific Railroad Company, or its successors, or any Acts in modification thereof or supplemental thereto.

Approved, June 25, 1929.

October 17, 1929.
[H. J. Res. 80.]
[Pub. Res., No. 20.]

CHAP. 43.—Joint Resolution Authorizing the postponement of the date of maturity of the principal of the indebtedness of the French Republic to the United States in respect of the purchase of surplus war supplies.

French Republic.
Agreement authorized to postpone paying indebtedness of, for surplus war supplies.
Post, p. 43.

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That in the event that the agreement between the French Republic and the United States (known as the Mellon-Berenger agreement) made on behalf of the United States by the World War Foreign Debt Commission and approved by the President, providing for the funding and payment of the indebtedness of the French Republic to the United States is ratified in France in accordance with the terms thereof, prior to August 1, 1929, the Secretary of the Treasury, with the

June 9, 1916.
[H. R. 14864.]
[Public, No. 86.]

Amended

CHAP. 137.—An Act To alter and amend an Act entitled "An Act granting lands to aid in the construction of a railroad and telegraph line from the Central Pacific Railroad, in California, to Portland, in Oregon," approved July twenty-fifth, eighteen hundred and sixty-six, as amended by the Acts of eighteen hundred and sixty-eight and eighteen hundred and sixty-nine, and to alter and amend an Act entitled "An Act granting lands to aid in the construction of a railroad and telegraph line from Portland to Astoria and McMinnville, in the State of Oregon," approved May fourth, eighteen hundred and seventy, and for other purposes.

Oregon-California land grant acts.
Preamble.
Vol. 14, p. 239.
Vol. 16, pp. 47, 94.

Whereas by the Acts of Congress approved April tenth, eighteen hundred and sixty-nine (Fourteenth Statutes at Large, page two hundred and thirty-nine), and May fourth, eighteen hundred and seventy (Sixteenth Statutes at Large, page ninety-four), it was provided that the lands granted to aid in the construction of certain railroads from Portland, in the State of Oregon, to the northern boundary of the State of California, and from Portland to Astoria and McMinnville, in the State of Oregon, should be sold to actual settlers only, in quantities not exceeding one hundred and sixty acres to each person and at prices not greater than $2.50 per acre; and

Whereas the Oregon and California Railroad Company, beneficiary of said acts, has violated the terms under which the said lands were granted by selling certain of said lands to persons other than actual settlers, by selling in quantities of more than one-quarter section to each person, by selling at prices in excess of $2.50 per acre, and by refusing to sell any further portions of such lands to actual settlers at any price, and in so doing has willfully violated the terms of the statutes by which the said lands were granted; and

Vol. 35, p. 571.

Whereas in the suit instituted by the Attorney General of the United States, pursuant to the authority and direction contained in the joint resolution of April thirtieth, nineteen hundred and eight (Thirty-fifth Statutes at Large, page five hundred and seventy-one), the Supreme Court of the United States, in its decision rendered June twenty-first, nineteen hundred and fifteen (Two hundred and thirty-eighth United States, page three hundred and ninety-three), ordered that the Oregon and California Railroad Company be enjoined from making further sales of lands in violation of the law, and that the said railroad company be further enjoined from making any sales whatever of either the land or the timber thereon until Congress should have a reasonable opportunity to provide for the disposition of said lands in accordance with such policy as Congress might deem fitting under the circumstances and at the same time secure to the railroad company all the value conferred by the granting Acts; and

Vol. 14, p. 242.

Whereas it was expressly provided by section twelve of the Act of July twenty-fifth, eighteen hundred and sixty-six (Fourteenth Statutes at Large, page two hundred and thirty-nine), that Congress might at any time, having due regard for the rights of the grantee railroad company, add to, alter, amend, or repeal the Act making the grant; and

Whereas the Oregon and California Railroad Company and its predecessors in interest received a large sum of money from sales of said land for prices in excess of $2.50 per acre, and from leases, interest on contracts, and so forth; and

Whereas the aforesaid granting Acts conferred upon the said railroad company the right to receive not more than $2.50 per acre for each acre of land so granted: Therefore

Oregon and California Railroad Company.
Land grants to, revested in United States.
Vol. 14, p. 239.
Vol. 15, p. 80; Vol. 16, p. 47.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the title to so much of the lands granted by the Act of July twenty-fifth, eighteen hundred and sixty-six, entitled "An Act granting lands to aid in the construction of a railroad and telegraph line from the Central Pacific Railroad in California to Portland, in Oregon," as amended by the Acts of

Vol. 16, p. 94.

Proviso.
Rights of way, etc., excepted.

eighteen hundred and sixty-eight and eighteen hundred and sixty-nine, for which patents have been issued by the United States, or for which the grantee is entitled to receive patents under said grant, and to so much of the lands granted by the Act of May fourth, eighteen hundred and seventy, entitled "An Act granting lands to aid in the construction of a railroad and telegraph line from Portland to Astoria and McMinnville, in the State of Oregon," for which patents have been issued by the United States, or for which the grantee is entitled to receive patents under said grant, as had not been sold by the Oregon and California Railroad Company prior to July first, nineteen hundred and thirteen, be, and the same is hereby, revested in the United States: *Provided*, That the provisions of this Act shall not apply to the right of way to the extent of one hundred feet in width on each side of the railroad and all lands in actual use by said railroad company on December ninth, nineteen hundred and fifteen, for depots, sidetracks, wood yards, and standing grounds.

Classification of restored lands.

Sec. 2. That the Secretary of the Interior, in cooperation with the Secretary of Agriculture, or otherwise, is hereby authorized and directed, after due examination in the field, to classify said lands by the smallest legal subdivisions thereof into three classes, as follows:

Power-site lands.

Class one. Power-site lands, which shall include only such lands as are chiefly valuable for water-power sites, which lands shall be subject to withdrawal and such use and disposition as has been or may be provided by law for other public lands of like character.

Timberlands.

Class two. Timberlands, which shall include lands bearing a growth of timber not less than three hundred thousand feet board measure on each forty-acre subdivision.

Agricultural lands.

Class three. Agricultural lands, which shall include all lands not falling within either of the two other classes:

Proviso.
Reclassification.

Rights of way, etc., allowed.

Provided, That any of said lands, however classified, may be reclassified, if, because of a change of conditions or other reasons, such action is required to denote properly the true character and class of such lands: *Provided further*, That all the general laws of the United States now existing or hereafter enacted relating to the granting of rights of way over or permits for the use of public lands shall be applicable to all lands title to which is revested in the United States under the provisions of this Act. All lands disposed of under the provisions of this Act shall be subject to all rights of way which the Secretary of the Interior shall at any time deem necessary for the removal of the timber from any lands of class two.

Mineral entries, etc.

Proviso.
Timber reserved.

Sec. 3. That the classification provided for by the preceding section shall not operate to exclude from exploration, entry, and disposition, under the mineral-land laws of the United States, any of said lands, except power sites, which are chiefly valuable for the mineral deposits contained therein, and the general mineral laws are hereby extended to all of said lands, except power sites: *Provided*, That any person entering mineral lands of class two shall not acquire title to the timber thereon, which shall be sold as hereinafter provided in section four, but he shall have the right to use so much of the timber thereon as may be necessary in the development and operation of his mine until such time as such timber is sold by the United States.

Timber lands.
Opened to homestead entry, etc., when timber removed.

Sec. 4. That nonmineral lands of class two shall not be disposed of until the Secretary of the Interior has determined and announced that the merchantable timber thereon has been removed, and thereupon said lands shall fall into class three and be disposed of in the manner hereinafter provided for the disposal of lands of that class.

Sales of timber by competitive bidding.

The timber on lands of class two shall be sold for cash by the Secretary of the Interior, in cooperation with the Secretary of Agriculture, or otherwise, to citizens of the United States, associations of such citizens, and corporations organized under the laws of the

Proviso.
Rejection of unsatisfactory bids.
Sale of small units.
Timber sales.

United States, or any State, Territory, or District thereof, at such times, in such quantities, and under such plan of public competitive bidding as in the judgment of the Secretary of the Interior may produce the best results: *Provided*, That said Secretary shall have the right to reject any bid where he has reason to believe that the price offered is inadequate, and may reoffer the timber until a satisfactory bid is received: *Provided further*, That upon application of a qualified purchaser that any legal subdivision shall be separately offered for sale such subdivision shall be separately offered before being included in any offer of a larger unit, if such application be filed within ninety days prior to such offer: *And provided further*, That said timber shall be sold as rapidly as reasonable prices can be secured therefor in a normal market.

Issue of timber patents.
Cutting, removal, etc.
Amended 41:597
Proviso.
Termination.

The Secretary of the Interior shall as soon as the purchase price is fully paid by any person purchasing under the provisions of this section issue to such purchaser a patent conveying the timber and expressly reserving the land to the United States. The timber thus purchased may be cut and removed by the purchaser, his heirs or assigns, within such period as may be fixed by the Secretary of the Interior, which period shall be designated in the patent; all rights under said patent shall cease and terminate at the expiration of said period: *Provided*, That in the event the timber is removed prior to the expiration of said period the Secretary of the Interior shall make due announcement thereof, whereupon all rights under the patent shall cease.

Tax, etc.

No timber shall be removed until the issuance of patent therefor. All timber sold under this Act shall be subject to the taxing power of the States apart from the land as soon as patents are issued as provided for herein.

Agricultural lands.
Opening to entry.
Vol. 38, p. 113.
No commutation.
R. S., sec. 2301, p. 421.
Cultivation, etc., required.
Provisos.
Cleared timberlands.
Preference to present residents.
On timber lands.

Sec. 5. That nonmineral lands of class three shall be subject to entry under the general provisions of the homestead laws of the United States, except as modified herein, and opened to entry in accordance with the provisions of the Act of September thirtieth, nineteen hundred and thirteen (Thirty-eighth Statutes at Large, page one hundred and thirteen). Fifty cents per acre shall be paid at the time the original entry is allowed and $2 per acre when final proof is made. The provisions of section twenty-three hundred and one, Revised Statutes, shall not apply to any entry hereunder and no patent shall issue until the entryman has resided upon and cultivated the land for a period of three years, proof of which shall be made at any time within five years from date of entry. The area cultivated shall be such as to satisfy the Secretary of the Interior that the entry is made in good faith for the purpose of settlement and not for speculation: *Provided*, That the payment of $2.50 per acre shall not be required from homestead entrymen upon lands of class two when the same shall become subject to entry as agricultural lands in class three: *Provided further*, That during the period fixed for the submission of applications to make entry under this section any person duly qualified to enter such lands who has resided thereon, to the same extent and in the same manner as is required under the homestead laws, since the first day of December, nineteen hundred and thirteen, and who has improved the land and devoted some portion thereof to agricultural use, and who shall have maintained his residence to the date of such application, shall have the preferred right to enter the quarter section upon which he was so residing whether such lands shall be of class two or class three and where such quarter section does not contain more than one million two hundred thousand feet board measure of timber, and where the quarter section contains more than the said quantity of timber such person may enter the forty-acre tract, or lot or lots containing approximately forty acres, upon which

Prior homestead not a bar.

Special reservation for two years.

Description.

his improvements, or the greater part thereof, are situated: *Provided further*, That a prior exercise of the homestead right by any such person shall not be a bar to the exercise of such preference rights: *And provided further*, That all of the following described lands which may become revested in the United States by operation of this Act, to-wit: Township one south, range five east, sections twenty-three and thirty-five; township one south, range six east, sections three, five, seven, nine, seventeen, nineteen, twenty-nine, thirty-one, and thirty-three; township two south, range five east, sections one and three; township two south, range six east, sections one, three, five, seven, nine, and eleven; township two south, range seven east, section seven; township three south, range three east, section fifteen; township four south, range four east, sections eleven and thirteen; township four south, range five east, sections nineteen and twenty-nine; and township twelve south, range seven west, sections fifteen, twenty-one, twenty-three, twenty-seven, thirty-three, and thirty-five, Willamette meridian and base, State of Oregon, shall be withheld from entry or other disposition for a period of two years after the approval hereof.

Amended
45:557

Commissions for timber sales.

Amended
60:1100 §403

Sec. 6. That persons who purchase timber on lands of class two shall be required to pay a commission of one-fifth of one per centum of the purchase price paid, to be divided equally between the register and receiver, within the maximum compensation allowed them by law; and the register and receiver shall receive no other compensation whatever for services rendered in connection with the sales of timber under the provisions of section four of this Act.

Legal proceedings to determine amount due railroad company.

Sec. 7. That the Attorney General of the United States be, and he is hereby, authorized and directed to institute and prosecute any and all suits in equity and actions at law against the Oregon and California Railroad Company, and any other proper party which he may deem appropriate, to have determined the amount of moneys which have been received by the said railroad company or its predecessors from or on account of any of said granted lands, whether sold or unsold, patented or unpatented, and which should be charged against it as a part of the "full value" secured to the grantees under said granting Acts as heretofore interpreted by the Supreme Court. In making this determination the court shall take into consideration and give due and proper legal effect to all receipts of money from sales of land or timber, forfeited contracts, rent, timber depredations, and interest on contracts, or from any other source relating to said lands; also to the value of timber taken from said lands and used by said grantees or their successor or successors. In making this determination in the aforementioned suit or suits the court shall also determine, on the application of the Attorney General, the amount of the taxes on said lands paid by the United States, as provided in this Act, and which should in law have been paid by the said Oregon and California Railroad Company, and the amount thus determined shall be treated as money received by said railroad company.

Matters to be considered.

Determination as to taxes due.

Title to moneys now in court.

Sec. 8. That the title to all money arising out of said grant lands and now on deposit to await the final outcome of said suit commenced by the United States in pursuance of said joint resolution of nineteen hundred and eight is hereby vested in the United States, and the United States is subrogated to all the rights and remedies of the obligee or obligees, and especially of Louis L. Sharp as commissioner, under any contract for the purchase of timber on the grant lands.

Payment of accrued State taxes.

Sec. 9. That the taxes accrued and now unpaid on the lands revested in the United States, whether situate in the State of Oregon or State of Washington, shall be paid by the Treasurer of the United States, upon the order of the Secretary of the Interior, as soon as may be after the approval of this Act, and a sum sufficient to make such payment is hereby appropriated, out of any money in the Treasury not otherwise appropriated.

Receipts from lands and timber to constitute special fund.

Disposition of.

Amended 45:1[illegible] [illegible]

Sec. 10. That all moneys received from or on account of said lands and timber under the provisions of this Act shall be deposited in the Treasury of the United States in a special fund, to be designated "The Oregon and California land-grant fund," which fund shall be disposed of in the following manner: The Secretary of the Interior shall ascertain as soon as may be the exact number of acres of said lands, sold or unsold, patented to the Oregon and California Railroad Company, or its predecessors, and the number of acres of unpatented lands which said railroad company is entitled to receive under the terms of said grants and the value of said lands at $2.50 per acre. From the sum thus ascertained he shall deduct the amount already received by the said railroad company and its predecessors in interest on account of said lands and which should be charged against it as determined under section seven of this Act; and a sum equal to the balance thus resulting shall be paid, as herein provided, to the said railroad company, its successors or assigns, and to those having liens on the land, as their respective interests may appear. The amount due lien holders shall be evidenced either by the consent, in writing, of the railroad company or by a judgment of a court of competent jurisdiction in a suit to which the railroad company and the lien holders are parties. Payments shall be made from time to time, as the fund accumulates, by the Treasurer of the United States upon the order of the Secretary of the Interior: *Provided, however*, That if, upon the expiration of ten years from the approval of this Act, the proceeds derived from the sale of lands and timber are not sufficient to pay the full amount which the said railroad company, its successors or assigns, are entitled to receive, the balance due shall be paid from the general funds in the Treasury of the United States, and an appropriation shall be made therefor. After the said railroad company, its successors or assigns, and the lien holders shall have been paid the amount to which they are entitled, as provided herein, an amount equal to that paid for accumulated taxes, as provided in section nine hereof, shall be deposited in the Treasury to the credit of the United States, thereafter all other moneys received from the sales of land and timber shall be distributed as follows:

Payment to railroad company, etc.

Proviso. Balance if receipts insufficient.

Distribution after paying railroad company, etc.

From sales of lands and timber.

Amended 60:1180 &407

A separate account shall be kept in the General Land Office of the sales of land and timber within each county in which any of said lands are situated, and, after deducting from the amount of the proceeds arising from such sales in each county a sum equal to that applied to pay the accrued taxes in that county and a sum equal to $2.50 per acre for each acre of such land therein title to which is revested in the United States under this Act, twenty-five per centum of the remainder shall be paid to the State treasurer of the State in which the land is located, to be and become a part of the irreducible school fund of the State; twenty-five per centum shall be paid to the treasurer of the county for common schools, roads, highways, bridges, and port districts, to be apportioned by the county courts for the several purposes above named; forty per centum shall be paid into, reserved, and appropriated as a part of the fund created by the Act of Congress approved June seventeenth, nineteen hundred and two, known as the reclamation Act; ten per centum shall become a part of the general fund in the Treasury of the United States; and of the balance remaining in said Oregon and California land grant fund from whatsoever source derived twenty-five per centum shall be paid to the State treasurer of the State in which the land is located, to be and become a part of the irreducible school fund of the State; twenty-five per centum shall be paid to the treasurer of the county for common schools, roads, highways, bridges, and port districts, to be apportioned by the county

Vol. 32, p. 388.

From other sources.

courts for the several purposes above named; and the remainder shall become a part of the general fund in the Treasury of the United States. The payments herein authorized shall be made to the treasurers of the States and counties, respectively, by the Treasurer of the United States, upon the order of the Secretary of the Interior, as soon as may be after the close of each fiscal year during which the moneys were received: *Provided*, That none of the payments to the States and counties and to the reclamation fund in this section provided for shall be made until the amount due the Oregon and California Railroad Company, its successors or assigns, has been fully paid, and the Treasury reimbursed for all taxes paid pursuant to the provisions of section nine of this Act.

Payments authorized.

Proviso.
Conditions.

SEC. 11. That the Secretary of the Interior is hereby authorized to perform any and all acts and to make such rules and regulations as may be necessary and proper for the purpose of carrying the provisions of this Act into full force and effect; and any person, applicant, purchaser, entryman, or witness who shall swear falsely in any affidavit or proceeding required hereunder or under the regulations issued by the Secretary of the Interior shall be guilty of perjury and liable to the penalties prescribed therefor.

Regulations, etc.

Punishment for false swearing.

SEC. 12. That the sum of $100,000 be, and the same is hereby, appropriated, out of any moneys in the Treasury not otherwise appropriated, to enable the Secretary of the Interior, in cooperation with the Secretary of Agriculture, or otherwise, to complete the classification of the lands as herein provided, which amount shall be immediately available and shall remain available until such classification shall have been completed.

Appropriation for classification.

Approved, June 9, 1916.

June 12, 1916.
[S. 6073.]

[Public, No. 87.]

Local

CHAP. 139.—An Act Granting the consent of Congress to George Fabyan to construct a bridge across the Fox River.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the consent of Congress is hereby granted to George Fabyan, and his successors and assigns, to construct, maintain, and operate a bridge and approaches thereto across the Fox River, at a point suitable to the interests of navigation, at or near Geneva, in the county of Kane, in the State of Illinois, in accordance with the provisions of the Act entitled "An Act to regulate the construction of bridges over navigable waters," approved March twenty-third, nineteen hundred and six.

Fox River.
George Fabyan may bridge, at Geneva, Ill.

Construction.
Vol. 34, p. 84.

SEC. 2. That the right to alter, amend, or repeal this Act is hereby expressly reserved.

Amendment.

Approved, June 12, 1916.

Perm. Local ch. 14

June 12, 1916.
[H. R. 12835.]

[Public, No. 88.]

Repeals
70A:65

(39:1651 Art. I

CHAP. 140.—An Act To authorize and empower officers and enlisted men of the Navy and Marine Corps to serve under the Government of the Republic of Haiti, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the President of the United States be, and he is hereby, authorized, in his discretion, to detail to assist the Republic of Haiti such officers and enlisted men of the United States Navy and the United States Marine Corps as may be mutually agreed upon by him and the President of the Republic of Haiti: *Provided*, That the officers and enlisted men so detailed be, and they are hereby, authorized to accept from the Government of Haiti the said employment with compensation and emoluments from the said Government of Haiti, subject to the approval of the President of the United States.

Haiti.
Details from Navy and Marine Corps authorized for.
Treaties, p. 44. 1658

Proviso.
Compensation permitted.

Superseded by
44:565 2

STATEMENT OF
NORTH DAKOTA TAX COMMISSIONER
KENT CONRAD
TO THE
REGULATORY REFORM SUBCOMMITTEE OF THE SENATE JUDICIARY COMMITTEE
WASHINGTON, D.C.

MARCH 26, 1982

I urge the U.S. Congress to take action against the plans of Burlington Northern to continue a holding company corporate structure. Inaction on this matter would allow the holding company to draw resources away from rail operations, which will cause increased abandonments, and which will harm the economic viability of the towns and communities dependent on Burlington Northern rail operations as the single lifeline for the transport of goods and services.

As Tax Commissioner of the State of North Dakota, concerns have been expressed to me by farm, labor, business and civic leaders that Burlington Northern's newly formed holding company structure could have an adverse effect on rail operations. Burlington Northern has already announced extensive branch line abandonment plans in nearly all of its service areas. The fear is shared by many North Dakotans that the Burlington Northern corporate re-structuring could result in even more abandonment.

These concerns were expressed to me at a hearing I held entitled "Burlington Northern: Its Continuing Responsibilities as a Land Grant Railroad" in Bismarck, North Dakota, on September 30 and October 1, 1981. The purpose of the hearing was to explore the responsibility of Burlington Northern to use its vast land grant mineral resources to support rail operations as intended by Congress when the grants were made to Burlington Northern's predecessors. The further intent of the hearing was to explore the effect of Burlington Northern's decision to form a holding company, the effect of that decision on branch line abandonment, and the effects of branch line abandonment on the rural economy. In addition, the effects of BN's holding company decision on the tax base of North Dakota were also reviewed.

These issues were addressed through four questions that I asked of participants at the hearing:

1. Will a holding company hurt the rail operation?

2. Has the railroad paid for the land grant assets it has received?

3. Does the railroad intend to separate land grant assets from the railroad itself?

4. Will the holding company move place Burlington Northern in a position to be anticompetitive in terms of development of coal resources in North Dakota and the region?

The hearing proved successful in answering those questions. My conclusions from the hearing and from researching railroad and federal reports on the matter are as follows:

1. Burlington Northern now holds mineable reserves of coal totaling 14.7 billion tons, mineable reserves of iron ore and taconite totaling 547.7 million tons, proven reserves of oil totaling 15.6 million barrels, proven reserves of gas totaling 35.6 billion cubic feet, and 1.5 million acres of timber lands. Those resources largely result from 46 million acres of land grants to Burlington Northern's predecessors from the federal domain in the 1860's.

2. Burlington Northern was restructured as a holding company in 1981. Management advocated to stockholders in an April 7, 1981, proxy statement that the holding company would provide "greater

flexibility to finance non-transportation business activities to expand through acquisition of new businesses, and to develop natural resources owned by it or its subsidiaries."

3. BN has made clear its intention to transfer the land grant assets or the wealth of those assets to non-rail subsidiaries of the holding company, even though the actual transfer of the assets is prohibited by indentures on old Northern Pacific bonds. BN told stockholders in the April 7, 1981, proxy statement. "Management believes that development of the Railroad's natural resources and non-railroad properties could be facilitated if transferred to the holding company or other subsidiaries of the holding company. If formation of the holding company is approved by stockholders, it is likely that some of these resources and properties will be transferred to the holding company ..." If the assets cannot be directly transferred to the non-rail subsidiaries, the assets will more than likely be leased to the non-rail subsidiaries at less than full market value.

4. The restructuring poses a potential threat to the financial well-being of the rail operation. In this regard, the ICC has stated in its Railroad Conglomerates and Other Corporate Structures:

> "Our concern lies in the fact that railroad noncarrier resources and income have been divorced from the railroads in many, if not most, cases without adequate compensation. As a result, while the stockholder has lost nothing and perhaps has even gained in terms of equity and earnings, the railroad as an instrument of public service has been deprived of wealth accumulated over many years, including resources such as land grants provided at public expense."

If the most profitable part of the company is separated from the rail operations, inevitably the rail operations must suffer. For example, BN's 1980 Annual Report shows that while four of the eight profit centers contributed just 6% of the company's total 1980 operating revenues, the same four profit centers contributed over 35% of the total profit. Those were forest management, oil and gas, coal and minerals, and land and real estate operations, the wealth of which derives from the land grants and which company management intends to further develop under the holding company structure.

5. Rail service is a vital link in the farm-to-market transport system. A decline in rail service is a tragic blow to any rural community. Without rail service, the country grain elevator, which represents the primary business entity in many small communities, may be forced to close, and the town would be a long way towards its death. Abandonment means a loss of tax base. It means additional taxpayer costs for road construction and repair. The loss of small elevators means a loss of bargaining power for farmers, who are forced to deal with a few large subterminal operators.

6. The value of the land grant resources to Burlington Northern far exceeds any benefit received by the public in exchange for the grants. The elimination by Congress in 1945 of the requirement for reduced rates from the land grant railroads did not mean the end of BN's responsibility to the public for those lands. Further, Congress failed in its analysis of the benefits received by the railroads to attach any value whatsoever to the minerals under the land grant lands received by the rail-

roads. The land grants were given to the railroads to help in building and maintaining a rail system. The lands are of obvious value today, as was the case when they were granted to BN's predecessors.

7. Burlington Northern's intentions to develop its coal reserves could result in anticompetitive behavior in the coal business. The U. S. Department of Justice, in its 1980 report entitled "Competition in the Coal Industry" cited BN as having market power over the transportation of coal in particular markets in which BN owned substantial coal reserves. What results is a desire by Burlington Northern to limit rail service to competing coal companies, and the possibility of higher coal prices. Any limitation on rail service to competing coal companies would also mean a limit in service to farmers along such lines.

I recently shared these conclusions with the Interstate Commerce Commission in a letter to Chairman Reese Taylor and urged that the Commission also take action against the plans of Burlington Northern to continue the holding company corporate structure. However, the ICC has argued in the past that it has no jurisdiction over the Burlington Northern holding company. Hence, I do urge Congressional action to clarify this issue.

The stakes in this matter are high. On the one hand, the stockholders of Burlington Northern stand to gain a great deal from development of its land grant mineral resources. However, I believe there is an overriding public interest in requiring Burlington Northern to keep the mineral and land interest holdings given it from the public domain coupled to its rail operations. With the adverse effect the holding company could have on rail operations, the formation of the BN holding company and any subsequent transfer of assets to nonrail subsidiaries is of considerable seriousness to the public.

Therefore, I again urge the Congress to take action to prevent the BN holding company structure.

BURLINGTON NORTHERN:
ITS CONTINUING RESPONSIBILITIES AS A LAND GRANT RAILROAD

TRANSCRIPT OF HEARING
BEFORE NORTH DAKOTA
STATE TAX COMMISSIONER
Kent Conrad

Taken At
Office of the State Tax Commissioner
State Capitol
Bismarck, North Dakota
September 30, 1981
and
North Dakota Heritage Center
On the Grounds of the State Capitol
Bismarck, North Dakota
October 1, 1981

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This copy contains corrections
to the original hearing record.

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(The following proceedings were had and made of record herein, commencing at 1:00 p.m. Wednesday, September 30, 1981:)

COMMISSIONER CONRAD: Maybe we should just indicate that this is the auxiliary hearing on Burlington Northern and its continuing responsibilities as a land-grant railroad. And we will be taking testimony today from those who are unable to attend the larger hearing tomorrow. Today on the schedule, we'll have Gene Griffin, Director of the Upper Great Plains Transportation Institute; Gary Berreth, Director of the Intermodal Planning and Rail Assistance Office of the North Dakota Highway Department; and Mr. Bill Fogarty, Administrator, Transportation Division, Montana Department of Commerce.

I should indicate at the outset that what we intend to do is to establish what responsibilities Burlington Northern has as continuation of its responsibilities as a land-grant railroad; and that we intend to explore that question in its many facets, including the effect of the formation of a holding company, whether or not that has an adverse effect on the rail operations; if so, what actions can be taken by public officials in the State of North Dakota to prevent the formation or the continued holding company structure of BN; if they have already formed the holding company, what could be done to prevent the transfer of land-grant assets away from the holding company. And there are additional auxiliary issues that we will want to address, including the effect on branch line abandonment and what highway costs and how highway costs will be affected by the branch line abandonments that have already been announced by Burlington Northern, both in the three-year plan and for future study.

So with that, maybe we could start with Gary and, perhaps, you could present your testimony, then we'll briefly have some questions and then go to Gene.

MR. GARY BERRETH: My name is Gary Berreth from the North Dakota State Highway Department.

I will begin by giving you a brief explanation of the situation as it seems to exist today in North Dakota with respect to the railroad service and lines in the State. Annually, by federal law, the railroads are required to submit to each state a category map or system diagram map that will categorize the rail lines, on each of their railroad systems, into one of three categories. Category one are those lines that they anticipate will be abandoned within three years. Category two are those lines that they presently have under study for possible future abandonment. No. 3 are those lines that they have identified as either pending abandonment application before the ICC or already have been abandoned. The number of miles of branch lines in the State of North Dakota in each of those varying categories: Category 1, the abandonment within three years, 425 miles; category 2, future abandonment, 822 miles; and category 3 – again, I will repeat, some of these have already been abandoned or are pending abandonment before the ICC – 230 miles, for an approximate total of 1,478 miles. The major portion of these particular lines are Burlington Northern branch lines.

The railroads have indicated to the State that if a line is going to stay in service, it will have to meet certain criteria. No. 1 is that the line will have to show a profit to the railroad; No. 2, that line will have to have the capability of a 100-ton capacity in unit train configuration; No. 3, it will have to be able to maintain an operating speed of a minimum of 25 miles per hour.

There is one other criteria, although the railroads have not said so publicly. However, it appears to be a reality; that is, the fact that there must be competition within an area for them to retain service on a particular line.

COMMISSIONER CONRAD: On that point, would you indicate why you believe the fourth criteria; namely, competition, is, in fact, a consideration, even though it hasn't been publicly stated? Do you have some evidence that suggests to you that that's the case?

MR BERRETH: Well, one thing – it is an assumption – from a business standpoint, if you figure that they are looking at it from a business perspective, if – and they are profit maximizers, that if they do not have competition in an area, they have no need to incur additional costs for their operations. There have been instances on some lines with respect to the Milwaukee Railroad, where the Milwaukee has been forced to pull out of an area due to bankruptcy and the Burlington Northern has been approached on the possibility of picking up service in those areas. They have been hesitant to do so. And one of the reasons was – is that they did not wish to incur additional costs when they thought that they would receive the traffic, anyway.

COMMISSIONER CONRAD: Okay, so they have stated that?

MR. BERRETH: If not definitely stated, they have inferred it.

COMMISSIONER CONRAD: Okay. Very good. Thank you. I just wanted to make sure we had that clear.

MR. BERRETH: Okay. With respect to the impact that the –

COMMISSIONER CONRAD: Before we proceed, one other thing. There is a third point that's listed in the North Dakota 1981 State rail plan update. The line must be profitable enough to produce a rate of return greater than their cost of capital and comparable to other railroad property rates of return.

MR. BERRETH: That was the first one where I said it must produce a profit to them.

COMMISSIONER CONRAD: Okay. I am interested in the point you make here, greater than their cost of capital and comparable to other railroad property rates of return? Are we talking there, when we talk about the railroad property, strictly railroad operating property or are we talking about other assets that the railroad currently holds largely through specifically, coal, oil, forest management?

MR. BERRETH: Okay, the reason that it stated in there is – as one of the reasons is in the abandonment proceedings, the Interstate Commerce Commission looks upon the application made by their railroad and their financial portion of it. They look at a thing called opportunity costs. And my understanding of the opportunity costs – maybe Gene can add some light to that later – is if you can take the value of what you have there and make an investment somewhere else at a higher return or, at least, the cost that it is for them to borrow money, the interest on borrowing money, they should be allowed to do so. That is a – you know, a view that the Interstate Commerce Commission has taken. And that has definitely, I would say, accelerated the abandonment situation in the United States and North Dakota.

COMMISSIONER CONRAD: It seems to me a very important point because, if they have higher rate of return opportunities in the energy field, for example, and they choose to make those investments rather than investments in the rail operation, it would seem to me that would almost guarantee further branch line abandonment in that unless you have rehabilitation, unless you have maintenance, even though they are low rate of return investments, you can't expect branch lines to be profitable. Do you think that's a fair assessment?

MR. BERRETH: Yes, I think so.

COMMISSIONER CONRAD: Gene, did you have something you would like to add?

MR. GRIFFIN: How formal do you want this?

COMMISSIONER CONRAD: No. If you want to have something on the record –

MR. GRIFFIN: I was just going to say that the rate of return – it's a prescribed rule by the Interstate Commerce Commission, developed through rule-making proceedings.

COMMISSIONER CONRAD: What the rate of return target –

MR. GRIFFIN: What it has to be. They take the salvage value of the track. They plug that – the rate of return that's prescribed on an annual basis each year. The Interstate Commerce Commission determines what that rate of return will be.

COMMISSIONER CONRAD: Do you have any idea what that rate of return will be?

MR. GRIFFIN: 11.7 percent.

MR. BERRETH: 11.7 percent is the determination of the ICC adequacy for '79 and '80.

MR. GRIFFIN: That's where that figure comes from.

COMMISSIONER CONRAD: Thank you. Do you want to go ahead, Gary?

MR. BERRETH: If we look at the number of miles of lines that we could conceivably lose in North Dakota with category 1 and 3, which, again, are those pending before the ICC, those are the lines they expect to abandon within three years, we are faced with approximately 655 miles. That number of miles affects 59 communities in the State, with a population of 17,800 people. In those communities are 66 licensed elevators. The amount of grain in those communities that presently is being handled by the railroads that would be converted to highway usage would convert to 24,000 trucks, with a load of approximately 800 bushels per truck.

In those same communities, there presently are approximately 26,425 trucks at eight hundred bushels a truckload being hauled out of those areas. Approximately seven percent of the State would not have rail access within 25 miles of their area should those category 1 and 3 lines be lost. Should the category 2 lines go, which are those lines under study for possible future abandonment, we're looking at an additional loss of 825 miles. This 825 miles affects 87 communities, with a population of 22,200. There are 191 licensed elevators within those 87 communities. Approximately 46,200 additional trucks would be added to the highway system in those areas.

COMMISSIONER CONRAD: Gary, do you have any estimate of the additional cost in road maintenance and road construction that would be created by the additional truck traffic? Is there any calculation that's been made as to what kind of added costs we would get on a yearly basis or a biennial basis as a result of that increased truck traffic?

MR. BERRETH: At this point in time, all I can talk in is in terms of what might happen as far as the patterns would be concerned. To put this in perspective of exactly how many vehicle miles traveled it would add statewide, this number of trucks, this many loads, the vehicle miles traveled in the State would be minimal statewide.

Our concern, however, is that it changes the pattern of traffic in the State. An in the case of a consolidation of services, which might occur or be forced to occur, what we see happening is a funneling effect of traffic from an area down into a small area. We see the impact then occurring the closer you get to the end of that funnel.

COMMISSIONER CONRAD: Are we talking about a funnel here of being, for example, a subterminal facility?

MR. BERRETH: Yes, consolidation of services.

COMMISSIONER CONRAD: Okay.

MR. BERRETH: To give you an example, if you have eight elevators, you consolidate to put in a central loading point in the middle of all eight elevators, if each one of the eight elevators had one million bushels of grain a year that they handled previously, that one million bushels on a radius around that single elevator. Now, all eight million bushels could be funneled down into the middle where, instead of an impact of a million bushels being hauled on a particular load, you have the impact — potential impact of eight million bushels. It is difficult at this time to determine exactly where the impacts will be in the state until we can determine where some of the subterminal locations might conceivably be. The — how do I put it? Whether it is on the county system or the state system, again, is a question that will be — I guess, have to be answered by those people in the grain merchandising business as to where they are going to locate some of their facilities.

COMMISSIONER CONRAD: Let me just ask — specifically, I have had people in the Maddock area contact me. I am sure you are aware of the situation there. And they have told me that — that if the branch line was abandoned, that they believe the pressure on the roads in that area would be substantial. And, of course, since the harvest occurs in a compressed period of time and the trucks required for hauling there would be of large size and be hauling large loads, that the increased road maintenance and road construction would be a substantial dollar effect. Do you have any handle on the kind of impact we would be talking about in a specific situation like that in dollar terms or is it too early to estimate?

MR. BERRETH: What I could possibly explain — it has to do with the Maddock situation. The Highway Department builds roads due to constrained dollars. When they are constructed, we go through a process — what we call stage development. We build a highway to one stage one year, then come back a few years later and build it up to a higher stage.

COMMISSIONER CONRAD: Could you just indicate for the record what you are talking about when you are talking about different stages?

MR. BERRETH: Stage development has to do with the thickness of the pavement. Now, thickness of pavement — the thicker the pavement the more structural capability it has to handle heavier loads. Most of the highways today have been built to certain stages to handle the traffic we have today. If traffic patterns change considerably and all at once, we maybe have not allowed for that additional traffic over some of those roads. In other words, it may be built to four inches rather than six inches, but it probably will be needed.

The Maddock situation is a situation that if the rail line goes out, those people have indicated that their desire for hauling their grain will be north to the Soo Line. Well, the highway system north of Maddock, that was not the travel desired before for heavy trucks, so that particular highway would not be in a position to handle that additional traffic at this time. Now, if Maddock changed their mind and decided to haul a different direction, there is a chance that the highway system would be adequate going in another direction.

COMMISSIONER CONRAD: If the – if they did haul north – and they have indicated the same thing to me – that they would haul to the Soo Line – what – do you have any handle on what the additional cost would be?

MR. BERRETH: Not at this time, I do not. What would happen in a situation like that is, if the Highway Department – to accommodate such a situation, if the Highway Department had to change their priorities to fix that highway up, the money that would be spent there would detract from another improvement in another part of the State. This type of arrangement would change the entire priority system.

COMMISSIONER CONRAD: Do you have any general estimate – for example, do you know what stage that road that goes north from there is in now and what stage it would have to be and what some approximation is on what it would cost to bring it up to the stage desired for the heavy truck traffic we're moving north?

MR. BERRETH: No, I do not. I could get that for you. It would be in our – well, in our construction office, design office.

COMMISSIONER CONRAD: I would very much like to have that for the record. Maybe we would note for the record here that we would include those cost figures when they are available (See Appendix A.)

MR. BERRETH: All right. I will go back and check. The program that the Highway Department is involved with is called the Section 803 Program or Local Rail Service Assistance Act. Through this particular Act, Program, certain federal funds are made available to the State to try to improve local rail service.

Now, the emphasis to date has been to, No. 1, rehabilitate those lines that possibly could become viable; and, No. 2, if that could not occur, to try to alleviate the impact of abandonment that would occur in certain areas.

Some of the alternatives that shippers could be looking at with respect to losing rail service would be the rehabilitation of the rail facility, of which – which would amount to additional cost to those shippers. The cost for rehabilitation of a rail line could vary anywhere from fifty thousand dollars a mile to two hundred fifty thousand dollars a mile, depending on what would have to be done. Some of the other options they have are offering a subsidy to the railroad to pick up the difference between what they consider their costs to what a reasonable return would be.

Another option they would have is relocation. Now, that could be relocation of their existing facility or it could be relocation through a consolidation subterminal on a more viable line. Another option they would have would be to purchase a line up for abandonment from the owning railroad and actually operate that facility themselves. Of course, with that particular option, they would again be faced with a rehabilitation cost of their own.

There is present legislation in North Dakota to allow the establishment of railroad authority – State railroad authorities. Two or more political subdivisions can combine and form a railroad authority, which would allow them to – to plan, study, purchase, own, operate a particular rail line. It also gives them the ability to bond and tax.

A motor carrier alternative is also an alternative which many of the elevators will be faced with looking at. This is also, on the state law, a law that allows the railroads to place in trust with the State of North Dakota any lines that they wish to do so. At such time the carriers then would be relieved of all taxes and all liability with respect to that line.

Our first recommendation to shipper groups and elevators has been to formally organize so that we know who we are dealing with and to deal with one voice as far as the shippers in that area are concerned.

COMMISSIONER CONRAD: Gary, could I just interject and ask, what we're talking about here are different solutions, really, to the problem, different possibilities for what might happen with rail abandonment.

MR. BARRETH: Correct.

COMMISSIONER CONRAD: And in the – again, citing the 1981 State Rail Plan Update, on page 5, at the top of the page, it indicates, "The overall State transportation goal is to provide an efficient and cost-effective intermodal transportation system that provides optimum capability for the movement of people and goods."

I am wondering if there has been any calculation or whether or not there are any plans to calculate the differential costs of the various alternatives; that is, with increased truck traffic, there are additional highway costs that would be borne by the taxpayers of North Dakota. There will be additional costs of trucking which will be borne by farmers. The alternative there is, perhaps, rail rehabilitation. I think you have used the number – that rail rehabilitation could cost anywhere from fifty thousand to two hundred fifty thousand dollars a mile. I am wondering if there has been any calculation of the differential cost or whether there are plans to calculate that.

MR. BERRETH: Yes, there have been and there will be. Through our program, when we look at the alternatives that are available to shippers on a line, we are required, through the program, to look at the actual costs and alternatives. We have to calculate what's called a benefit cost analysis. The shortcomings in that particular process is that whatever solutions we may wish to do, if the railroad does not wish to retain that line or have an active role in being part of that solution, they do not have to, so we can lay out the alternatives, but in many instances, the most cost-effective one may not be –

COMMISSIONER CONRAD: Acceptable.

MR. BERRETH: Yes, be acceptable to the rail.

COMMISSIONER CONRAD: It seems to me, from a societal standpoint – and society has got a very strong interest here, especially when you have a railroad that has been the recipient of substantial land-grant assets – that from a societal point of view, we would want to have the optimal solution from a cost benefit analysis. Of course, we have to consider who is going to pay as well and because there are very major differences, depending on which way one goes, who pays.

MR. BERRETH: Part of the delimma that we are faced with when dealing with railroad transportation is that we're looking at rail transportation from many different perspectives. The railroad's perspective in looking at it is strictly a profit perspective. The shipper is looking at it from a profit, but a service perspective and his particular business. The producer is looking at it from the standpoint of transportation costs – minimum transportation costs which, in essence, would mean more money in his pocket. The State is looking at, partially, the social aspect, plus the overall service and economic well-being of the state as far as the effective and efficient movement of transportation and goods.

When we try to deal with that type of a situation, it's almost a juggling act as to how can we appease as many people as possible of the number of different characters that are involved. As far as our concerns, you mentioned service. That is a major concern, I guess, from our perspective. Competition is also another concern that the State is aware of. And I imagine Gene will be addressing this, but we are a land-locked state, captive to surface transportation. We are also concerned about external influences.

We do not have the desire to have something or someone external to our State manipulating our economy. The grain embargo, dock strikes, the unit train concept, the large one, whether it works or not, those are all things that – there is a hesitancy for us to want to see. Transfer of costs. This gets into the transportation – the things with highways. We are concerned that the rationalization of this rail system will amount to the transfer of costs. It will be the transfer of costs from the rail industry to the State of North Dakota, whether that be – by state, I mean, state government, shippers, producers and the general public.

COMMISSIONER CONRAD: Could I just ask you very quickly, are you familiar with the Highway Department budget and what percentage of that is provided by State funds and what percentage of Federal funds? If you don't have that –

MR. BERRETH: I can get that for you. I don't have it.

COMMISSIONER CONRAD: I would appreciate it if we could get that as well. What we are talking about is, in overall terms, the size of the budget, percentage provided by Federal and the amount provided by State funds.

One other question. Are there any calculations as to the energy efficiency of the competing modes of transportation that we're talking about here? Are there calculations as to the energy efficiency of hauling these large volumes on the rails versus on the roads in terms of energy efficiency?

MR. BERRETH: The factors you would have to consider in looking and comparing energy efficiencies would be the amount of traffic or whatever on a particular line and the distance it would have to travel. It is generally accepted and, I think, documented that on some branch lines in the State to take two or three rail cars up and down a line is not energy-efficient. In those instances, trucking is a cheaper alternative.

I know the Upper Great Plains Transportation Institute has looked into some of the efficiencies between – as far as trucking is concerned in long and short haul. Whether that is pertinent for this question, I don't know. You might ask Gene.

COMMISSIONER CONRAD: Okay, When we get to Gene –

MR. BERRETH: Depending on which industry you talk to, the trucking industry will argue that the trucking industry is efficient in any type of hauling system that the railroad industry is in. The rail industry has traditionally stated that their rightful place is for the long hauling of large quantities of bulk commodities. Now, whether you want to compare that to a branch line versus a main line system, I am not sure if you would want to do that right now.

COMMISSIONER CONRAD: That's fine. I am just interested in – perhaps from Gene – to provide his testimony – we can get into that a little bit more. If you have got something else –

MR. BERRETH: The only other thing, other than the transfer of costs that I mentioned – the concern with that transfer of cost is that we should be concerned that that transfer of cost is not a disproportionate transfer. We know that the rationalization of the rail system in North Dakota – what is being proposed by the Burlington Northern. If that takes place, it will mean more costs to someone in North Dakota, whether it be the shipper, the State or the producer.

Our other concern is the timing, the effect that the abandonment situation could develop into the changes that would result in that – in that situation cannot be accommodated if those changes all take place at the magnitude and within the short period of time that's anticipated.

COMMISSIONER CONRAD: What do you mean by that, that they can't be accommodated? I assume, from what you are saying there, there is not sufficient room in the budget of the State Highway Department to cover those additional costs in the short term. Is that correct?

MR. BERRETH: That's correct, plus the fact that if the subterminal concept does become a reality, there could be a tendency or a panic situation where we could end up with an overbuilt situation. That overbuilt situation could result in marginal facilities and good facilities going down with some of the poor ones that would be built along with them. The fact that the highway system is the only other alternate available if rail service is not there, whether it be to go to a central gathering point for grain and then go out by rail or not, the highway system is the only alternate mode.

We are concerned about the amount of funds that would be available to accommodate getting the highway system into such a condition that it could handle those additional loads. The State is going to be faced at a Federal level with a possible decrease in Federal dollars for highways. Should that occur, coupled with an increased demand upon the highway system, as far as costs, I am not sure where the money is going to come from.

COMMISSIONER CONRAD: Okay. Anything that you would like to add at this point?

MR. BERRETH: Let's see if I forgot anything.

COMMISSIONER CONRAD: Maybe I could ask one more question before we close; and, that is, you indicate – I don't know if you are the author of this report or not.

MR. BERRETH: Our division is, yes.

COMMISSIONER CONRAD: Okay. On page 15, the statement is made: "To date, the railroads have not indicated any willingness to do any more than routine maintenance on the majority of their branch lines." What's the evidence for that statement? Is that the experience statewide? Is that based on the experience of the SITT team in looking over what's going on across the State? What's the basis for that statement?

MR. BERRETH: The general condition of the branch line system in North Dakota today is such that most of them have light density rail and the general condition of the subgrade and everything dealing with those branch lines is relatively poor. The condition hasn't improved. It's not improved over the years. In other words, the way those lines were built in the early 1900's – there has not been a lot of improvement to those lines as far as upgrading their ability to handle the heavier cars and unit train configuration. Okay.

There is varying philosophies between railroads. Like, one railroad will say, "We cannot handle 100-ton hopper cars unless there is 90-pound rail or more." Another will say, "We can handle 100-ton hopper cars, but we can't handle them in unit train configurations on those lines." Both of those type of philosophies, more or less, preclude the branch line system from becoming an up-to-date system of moving commodities.

Most of the lines in the State have 60- 65-pound rail. Most of the ties will require, maybe, a third replacement. The ballast in many situations is nonexistent. Now, there are some lines that do not need this criteria, but I am saying that, maybe, the majority of the branch lines in this State are in that type of a situation. So if the railroads wanted to get it up to the capability of handling 100-ton hoppers in unit train configurations at a minimum of 25 miles per hour, considerable investment would have to be made at this time to bring those lines up to that particular standard; that, coupled with the fact that the equipment that the railroads use nowadays -- the traditional 40-foot boxcars, which was the lifeline of the branch line system, is being phased out. The railroads have gone to the 100-ton hopper car for their major piece of equipment in hauling grain. It's just like putting too heavy of a truck on a highway and that's what happens when you put too heavy of a grain car on a railroad line.

COMMISSIONER CONRAD: All right. Thank you very much for taking the time to provide your testimony. And if you would provide those answers to some of those questions that we had, we would appreciate that.

MR. BERRETH: Okay. If you need anything else, call me. I'll come back.

COMMISSIONER CONRAD: Gene, if you would identify yourself for the record, then proceed with your testimony.

MR. GRIFFIN: My name is Gene Griffin. I am Director of the Upper Great Plains Transportation Institute, North Dakota State University, Fargo, North Dakota.

Okay. What I will try and do is just lay out some general ideas about transportation, its importance to North Dakota and some of the changes I perceive in the future, what the causes may be, some of the underlying considerations there should be as a result of those changes.

First of all, the importance of freight commodity transportation to the State of North Dakota. As Gary mentioned, we are a land-lock state. We are one of the few states that are disadvantaged, I would say — I should change that and say, we are probably the most disadvantaged state when it comes to transportation, for a couple of reasons. One, the nature of the commodities that we ship, they are bulk agricultural commodities, bulk natural resources, such as coal, and so on.

We are more distant from the markets that buy those commodities or consume those commodities, so we don't produce them for our neighbors at the back door, so we do have to ship long distances. And, thirdly, we have only two alternate forms or modes of transportation; the truck mode and the rail mode. We do not have a water transportation system and it does not appear that we will probably ever have a water transportation system that serves the contiguous — or, that is, contiguous to this State.

That's not to imply that we don't use water, because we do it on the Columbia and the Snake on the West Coast and we use the Great Lakes system, the St. Lawrence seaway. We also use the inland waterway on the Mississippi River.

COMMISSIONER CONRAD: Before we go on, there has been a great deal of talk about barge transportation on the Missouri River. Could you give us just very quickly some insight as to the practicality of that form of transportation and whether or not it has a future.

MR. GRIFFIN: In my estimation, no, it doesn't. From an engineering point of view, there are considerable problems. I am not an engineer, but I have been told that. And the Corps has studied it extensively, I think. I am an economist and there are some real difficult economic problems with it. The construction costs, given the kind of payout that you need to make something like that pay, are just — just look very bad. It would be very effective for North Dakota as a form of competition if we could get it. It would be very desirable on the part of shippers in the State, but I am afraid that because of the economic reasons, engineering reasons, the environmental reasons and, also, now, the political reasons — I think they are political reasons — the mood of the country is not to go around, throw a bunch of money into water projects at the moment, so I don't think it's in the offing.

COMMISSIONER CONRAD: We appreciate that comment. I think it's important to have that as part of the record here so we have a full perspective. Thank you.

MR. GRIFFIN: It would be very desirable, but it doesn't look good. Okay. So we sit here in a State where we do need transportation services, large quantities of transportation services, because of the bulk nature of the commodities that we ship and we have these two modes. This does make us, essentially, a very captive state, although some people would say that you do have two modes of competition, you are not competitive. Essentially, if one of those modes is the preferred mode or if one of those modes is the mode which can provide the bulk of the capacity, then we do become, to a degree, captive to that mode. We believe that is the case with North Dakota.

We ship annually somewhere between three hundred and four hundred seventy-five million bushels out of this State in grain alone.

COMMISSIONER CONRAD: What's that number?

MR. GRIFFIN: Between three hundred million and four hundred seventy-five million bushels. That's been the range of shipments of grain out of this State within the last five years.

COMMISSIONER CONRAD: Do you have any handle on what the volume of coal being shipped in this State is? I am just not referring to North Dakota coal, but I understand there is a very small percentage –

MR. GRIFFIN: I really don't know. I couldn't tell you. I am sure it would be easy to find out. Those kinds of traffic statistics are available. So we – and somewhere between thirty-five and forty percent of that moves by truck. The balance moves by rail. It's inconceivable to me that we could increase our capacity – truck capacity to carry the balance of that traffic. I would say it would be virtually impossible, so we are very dependent to move it by rail.

COMMISSIONER CONRAD: Do you have any idea how much of that moves on the main lines, how much of it moves on the branch lines? I would assume there has got to be substantial overlap, but do you have any idea on the breakdown?

MR. GRIFFIN: I don't have it here. We can obtain that data very easily.

COMMISSIONER CONRAD: I would very much appreciate to have that.

MR. GRIFFIN: Secondly, I talked to –

COMMISSIONER CONRAD: Because you are on this captive question, Gene, one thing that has been of intense interest to us is the captive feature of the North Dakota market with regard to coal. What we're concerned about here is the very substantial coal ownership by Burlington Northern and the fact that they are, virtually, a monopoly hauler of coal and what effect that kind of interrelationship may have on coal development and other competitiveness of that market.

I think you may know that there is a Justice Department study that raises very serious questions as to the effect of a monopoly hauler, which also has major coal reserves, both in North Dakota and in the Powder River Basin, what kind of interrelationship there may be. I don't know if you had a chance to look into that issue or not.

MR. GRIFFIN: I have not looked into the issue. There was a specific section of the Interstate Commerce Act that prohibited railroads from entering into other businesses to remove the problem of them integrating vertically, both backwards and forwards and becoming a monopoly in a particular region or in a particular marketing of a commodity.

COMMISSIONER CONRAD: Now, with the formation of a holding company, I assume that the – the separate entity, which would be the coal development company, which is, as I understand it, would be called Hill Minerals in the case of Burlington Northern, would no longer be under that restriction. Is that your understanding of –

MR. GRIFFIN: I really couldn't tell you. I am not sure if the Staggers Rail Act amended that part of the old ICC Act prior to the Staggers Act, nor could I tell you, legally, what the implications are.

COMMISSIONER CONRAD: That would be an important question for us to get answered by the representatives from Burlington Northern tomorrow.

MR. GRIFFIN: I think so. Probably you should just take a look at the Interstate Commerce Act to see what the Staggers Act – how that might have affected – if that particular provision was amended.

Okay. I would like to talk a little bit about some of the changes that are occurring – well, maybe I can just touch on one other subject very briefly. And this is basically for educational purposes, because I don't know how much bearing it really has, except that the nature of the demand curve for transportation, particularly North Dakota transportation – now, I am talking about the total demand, not the demand for rail or demand for truck. But we have studied the demand curve and we found that it's very inelastic. In other words, it puts us pretty much – pretty much puts the priority of the service in the driver's seat when it comes to pricing.

The reason for this general inelasticity is because it's a derived demand. It's a derived demand for grain and food, which is the primary export. And that market, as a whole, is generally thought of to be inelastic.

Now, we found that there is a great deal of elasticity — cross elasticity between truck demand and rail demand. They do not act as good substitutes for one another. And that is evidenced, of course, by the amount of grain that is moved by the truck to major terminal markets. The consideration here is that it does allow the railroads to price approximately at truck costs. This is a revenue maximizing position for them.

Now, to the extent that they can be cost-effective in their own operations, they increase that revenue — they can retain or do whatever they wish with — because the extent that trucks can affect their cost structure or, basically, their supply curve is virtually totally ineffective, but railroads, on the other hand, can affect their cost structure and supply curve. And they do this in a number of ways. One is through the rationalization of their existing system. So I think that's —

COMMISSIONER CONRAD: What you are saying is, just so I make sure I understand what you are saying — I think I do — I think you are saying, at least as I hear it, that the rationalization — the further rationalization of the rail system can make a substantial difference to the bottom line?

MR. GRIFFIN: Absolutely. What they will try and do, of course — and they wouldn't do this if we're trying to work a private enterprise system — they will try and minimize their costs without affecting or minimally affecting the revenue side of their equation. It's that simple. They can do that. You see, trucks do not have that same capability. And so it ties back into the trucks in that they price up to the truck costs. And since the trucks have no —

COMMISSIONER CONRAD: So, really, what we're saying here is that it is in the railroad's interest to, perhaps, have a rail system that is not the optimal system for the transportation network of the State as a whole?

MR. GRIFFIN: It might work out that the system might be optimal for the State, but I guess that would be highly unlikely. It would be a — I just say, it would be highly unlikely that would happen, although I wouldn't rule it out. If the right rate concessions were given, it could be the optimal. The question is: Would the right rate concessions be given?

COMMISSIONER CONRAD: There's another point we should explore just briefly; and, that is, Burlington Northern has talked about a 15 cent a bushel rate concession for unit train hauls.

MR. GRIFFIN: Mm-hmm.

COMMISSIONER CONRAD: Is there any guarantee, that you are aware of, that that rate concession would continue after the formation of subterminals, any competitive reason why that should continue?

MR. GRIFFIN: Not necessarily. The rates have been published on a permanent basis. We're not a temporary rate base. I think, as a profit maximizing company, they will try and extract as much as they can. There is a great misunderstanding about how railroads price. And railroads use price discrimination. And the word "price discrimination" does not have bad connotations necessarily. It's a way of describing how they price. They will price very similar commodities or even the same commodity — they will discriminate in the price they charge to move that commodity, depending upon the surrounding transportation economic situation, to maximize revenue. And that's what price discrimination means. So, no, it's not necessarily guaranteed that we will always have that concession. Absolutely not.

MR. HARING: In the technical sense, do the railroads have market dominance in North Dakota? Does the Burlington Northern have market dominance?

MR. GRIFFIN: According to the rules of market dominance that have been published and promulgated by the ICC, I would question that we would have only but one or two of the commodities, one of them being, probably, barley to Minneapolis-St. Paul. That would probably be the only one that we would have a real sure bet on. The rest of them — the rules were written quite wide open, almost to the point that if you have an alternate form of transportation besides rail, you don't have market dominance. But we see that, for instance, 95 percent, roughly, of the barley moving to Minneapolis moves by rail, but there is five percent truck. And just the fact that there is a potential truck service, they would very well rule that we don't have market dominance even on that.

COMMISSIONER CONRAD: Gene, how about on coal?

MR. GRIFFIN: That becomes a bit more of a sticky problem. But, again, the Commission might just find, in a number of cases, that there are alternatives. And that's the key. Is there market competition? Is there alternative sources of supply? Is there alternative methods of moving the product? All those questions are — all those become a criteria.

COMMISSIONER CONRAD: I suppose, in the Big Stone example – for example, in the Big Stone situation, there, I don't – I can't think of any alternative to the delivery of the –

MR. GRIFFIN: Coal probably has a better chance for, probably, a number of reasons. One, technically, it probably fits better as a criteria. Two, I think that their political lobby is much stronger.

MR. HARING: Getting back to what you said a couple minutes ago about the cost curves, is cost a factor in determining market dominance? Let me read you something that's in the legislative history of the Staggers Rail Act of 1980. In describing the test of market dominance, it reads, "The test of a transportation alternative is a sound one. If a shipper can rely on a transportation alternative which could include another railroad, a barge, or a truck, at a transportation cost which is not substantially greater than the rail transportation cost, then competition is present." So that's the key that the cost –

MR. GRIFFIN: Right. And the paradox in that particular statement is that the transportation cost provided by the railroad will be very close to the actual truck costs incurred because of the pricing I mentioned earlier. That won't be – in no way have any relationship to the cost to providing the rail service.

COMMISSIONER CONRAD: Gene, do you have any numbers – the costs that have been incurred by the agricultural sector in North Dakota that would be – that would be considered excess costs for rail transportation? I have heard numbers that we have paid fifty million dollars a year – forty to fifty million dollars a year in what would be considered excess transportation costs because of pricing discrimination by the railroad. Do you have any handle on that kind of number?

MR. GRIFFIN: Yes, we do. We have been doing them for a number of years. Just to give you an approximation, back in 1975, I believe it was, we estimated that the revenue provided by grain exceeded the fully allocated costs in providing the service to move that grain by thirty-some million dollars annually.

COMMISSIONER CONRAD: Does the fully allocated cost include a profit margin?

MR. GRIFFIN: These figures should be taken with a grain of salt, but I think they do point to a general direction. One is that they do provide a rate of return, but it was embedded debt. The embedded debt at that time was quite low, like, around four and a half percent, I believe – four and a half to five percent. Another consideration is that these are average cost functions developed using regression analysis. The methodology was developed back in the '40's. It had been updated significantly over the years, but still they are average costs.

And so there is some skepticism as to how accurate they are. And it's – it's a fundamental cost accounting, economic arrangement which will probably never be resolved in our lifetime, anyway.

COMMISSIONER CONRAD: Gene, you've worked in this area for how long?

MR. GRIFFIN: About eight years.

COMMISSIONER CONRAD: About eight years. You have been the executive director –

MR. GRIFFIN: Just Director.

COMMISSIONER CONRAD: You have been the Director of the Upper Great Plains Transportation Institute for how long?

MR. GRIFFIN: Two years.

COMMISSIONER CONRAD: It would be safe to say, I think , you have very substantial experience in that area. What would be your best judgment as to the reliability of the numbers you have just talked about?

MR. GRIFFIN: Well, I used – I did the studies – I came up with them originally, so I can hardly say that they are probably not too reliable, but I would say that they do give an indication in a general direction that our – our rail rates in this State far exceed the costs of providing service. And that's because, as I have said earlier, that's how they maximize their profits.

If I could quickly touch on a couple other things, we have, currently, several things. We have abandonment of rail lines taking place, we have fundamental changes in the grain marketing system taking place. Like here, I am talking about what we call the delayed pricing contracts, merchandising grain in larger volumes. We have had the introduction of unit train rates, multiple car rate structures in this State. In the grain marketing business, we are seeing some vertical integration. By that, we are seeing domestic and export firms getting heavily involved in the country elevator business, country merchandising business.

COMMISSIONER CONRAD: In what way?

MR. GRIFFIN: Owning and doing their own country merchandising, owning actual facilities, and so on. So there are some very fundamental changes taking place that are affecting our traditional grain merchandising transportation handling system. And I think what I would like to do is just talk about why some of these things are happening at the same time.

And one of them is competition from competing producing regions. We have our main — our mainstay and our staple, if you will, commodity that we produce, which is wheat. The staple to our economy — our agricultural economy is wheat. Beyond that, we have three other — or two other alternatives. And wheat consists of both hard red spring, durum and a bit of hard red winter. Beyond that, we have barley and we have sunflowers.

Now, between wheat, barley and sunflowers, they constitute about 92 percent of our total movement out of our State, so those are the three that are important to us.

Wheat, as I said earlier, was the staple to our economy. And that wheat competes with wheat from other regions. For instance, one of the reasons that we are seeing multiple car and unit train rates to the West Coast and, eventually, east was because the Union Pacific, which has a totally different philosophy in marketing than the BN, decided that they were going to influence the way grain moved out of Nebraska, Kansas, Colorado, Wyoming. To do that, they wanted to move it to the West Coast.

COMMISSIONER CONRAD: Would you characterize the difference in marketing philosophies before we go on? I have heard this before. I have heard it a number of times. And I have really not known what people were addressing.

MR. GRIFFIN: I think the UP believes — and I think there are, really, honest differences in the approach. The UP, I think, has the philosophy or the concept that they can influence the movement of commodities and where they will go and how they will be marketed. In other words, they think they can influence corn movement to the West Coast. They think they can influence wheat movement to the West Coast. Prior to their development of rates, it used to move to the Gulf. The BN, on the other hand, I don't believe they think they can influence. They would rather capitalize on the existing movement or the traditional patterns of grain and prefer to meet competition as it develops rather than foster the competition itself. I think those are two different — basic different approaches to how do you win in the economic ball game of profit and loss.

COMMISSIONER CONRAD: Could I ask you one further question on this and then — before you go on? How would you characterize the Soo Line's philosophy because, over and over, I have been told by shippers that they see a very substantial difference between the philosophy of the Soo Line and the philosophy of Burlington Northern. Do you see a difference in the philosophy? And, if so, would you characterize it?

MR. GRIFFIN: Well, I think there is definitely a difference in operating practice. And I think there is a difference in philosophy. I think the Soo Line — and it stems for — it stems from a couple different things. One, it stems from the size of the two firms — absolute size — and geographic distribution. It also stems from the very nature of how they — where they derive their revenues from. I think the Soo Line, first of all, is much more attentive to its grain revenue and the service requirements necessary to achieve certain revenue goals than the BN. I think the BN has had, for instance, coal. It has had transcontinental traffic. It has had lumber, things like this, so it hasn't had to be as attentive, if you might.

I think that the Soo Line, becasue of the nature of its operation, its loop system, is not convinced of the unit train movement. I don't think they would like to see the multiple car concept implemented. So I think, you know, there are two different operations and they approach things differently. I think the Soo Line might be a bit easier to deal with and to at least communicate with than the BN at times.

The BN is an awful large organization. I suspect there are diseconomies of size when you get to be that big. It certainly isn't proven now, but, you know, I would hypothesize, when you get that big, as a railroad firm, that there are diseconomies of size.

Okay. Well, competition — as I was talking about, competition from competing regions. We're seeing right now — of course, a lot of people like to believe that hard red spring wheat is a quality — "quality" wheat. We can sell it for premium over whatever other wheat is selling for. I do not believe that is true any more. As a matter of fact, we have noted that trade teams — what the Wheat Commission has brought into this State has said that after the sprout damage they had a couple of years ago, that they were more interested in hard red winters because they used them in the years when there was sprout damage, found them quite acceptable to their baking needs. There are still some countries, because of certain ingrained eating habits, because of certain technological changes, they haven't adapted, such as the Philippines and Japan, will require certain amounts of high quality red spring wheat, but the problem of substitutability keeps nagging at us. And I think we will see the two wheats become almost perfect substitutes if they are not already there.

This year, we saw people looking for – in the markets in Kansas City, looking for low-protein hard red winters to mix with high-protein hard red winters that came off this year's crop. And they didn't need hard red spring at all. That's why, today, we look and we don't see a penny hardly for protein. So we got the substitutability problem.

We have competition. And the UP puts these rates in. The North Dakota producers are faced with a hell of a dilemma at this point. He has to somehow get his produce in position for export at the same price that the prevailing competitor is or he is out of the market.

COMMISSIONER CONRAD: Could you address what accounted for that size of differential, that amount of the differential?

MR. GRIFFIN: The UP reduced its rate that much.

COMMISSIONER CONRAD: They did it in order to capture and to move that?

MR. GRIFFIN: The wheat west from Kansas, Nebraska, Colorado.

COMMISSIONER CONRAD: Traditionally, that wheat had moved –

MR. GRIFFIN: To the Gulf. The reason they wanted to do it is because it was a long haul, a single-line move. It was an export move. It gave them such things as car control. It gave them more revenue versus going east or their line ended, terminates at Omaha and Kansas City. There, it had to be interlined, went into the domestic trade. Car control was down going west, car cycle time was up. There was everything good in it for them. So, similarly, we have got Canada to the north of us and, ultimately, in the broader sense of things, we have got Australia and Argentina to contend with. And in the case of soybeans, we have got Brazil. So, all of a sudden, we find ourselves trying to react to these external forces, these exogenous factors that we have little or no control over.

They do provide the BN with an opportunity to capitalize on them. And so what happened was, we saw a unit train rate in North Dakota. That's where it came from, the very first one. There were a couple of other reasons that were involved in it. One was the – there was a great amount of wheat moving out of Great Falls. Ninety-some percent was moving by truck because of the Columbia-Snake competition, the water competition. Now, as that happened, the BN was forced to reduce its rates to meet that competition if they wanted the traffic and they made the decision that they did.

And when they started to phase it into North Dakota, the only way they could do it was put it on a unit train and a 26-car unit and bring it back into this State.

Okay. Competition from competing regions should also be considered as an influencing factor. Energy inflation. Transportation is probably one of the most energy-intensive industries in the United States, not only in fuels, in the steel for the rails, the steel for the cars; and the locomotives, in the rubber tires; an energy intensive type of production process, the asphalting, and so on. So we're talking about a very energy-intensive process that has had a great deal of influence. The general level of inflation, railroad and highway and bridge quality, quantity, technology of farm trucks, capital replacement decisions by producers that own elevators – when it comes time that – in the form of cooperatives, when it comes time to replace them.

Now, an abandonment map, the nature that we have seen, has been published. They are going to be very skeptical about putting them on lines that have any color of ink on them, whether it be red or green, I think. And, then, at least – not the last, of course, and not an inconclusive list, legislation. We have had the Staggers Act, which mandated that we were going to have a profitable railroad system. It was going to remain in the private sector. And the only question that really wasn't answered was, Who was going to pay for it?

COMMISSIONER CONRAD: Gene, on that point, we've – and in this hearing there is a question focused on the question of the holding company. We've been looking at the effect of the holding company move on the rail system. We have found, you know, a number of items which raise our level of concern on this issue. The letter that I talked about in the meeting – two days ago in the PSC meeting, which is from the office of the Chairman of the ICC to the United States Senator Max Baucus, talks about the importance of nonrail income, primarily from natural resources, to BN, because it is – it has enabled it to maintain its credit rating – an A credit rating. This letter, again, is from the office of the Chairman of the ICC to Senator Baucus. It says, "Any lower rating would have made it extremely difficult for the company to have done any non-equipment financing. For example, during the five years 1976 through 1980 the combined earnings available to cover fixed charges totaled $1,059 million. Fixed charges over the same five-year period totaled $365 million, for a fixed charge coverage ratio of 2.9. Coverage of this magnitude is satisfactory to maintain an A rating. However, if non-railroad income is deducted from earnings available for fixed charges, the $1,059 million figure would be reduced by $774 million to $286 million or less than the total fixed charges of $3.65 million. Rail operations performed better in 1980, generating a fixed charge coverage ratio of 1.30, but that ratio would not have supported an A rating. Additionally, the improved rail earnings might not have been possible without the large investments in rail facilities financed in part by funds from natural resources and from outside financing permitted by the A rating partly attributable to natural resource income."

In addition, we have an ICC report, February 5, 1977, entitled "Railroad Conglomerates & Other Corporate Structures." I don't know if you are familiar with this report. But it makes much the same kind of point over and over again. It says, "Our concern lies in the fact that railroad non-carrier resources and income have been divorced from the railroads in many, if not most cases, without adequate compensation." I am talking about holding companies. "As a result, while the stockholder has lost nothing and perhaps has even gained in terms of equity and earnings, the railroad as an instrument of public service has been deprived of wealth accumulated over many years, including resources such as land grants provided at public expense. It is implicit that if the earnings of the railroad are not sufficient to satisfy the holding company management's perceived obligations to its stockholders, then as little money as possible would be spent on the railroad."

These are the kind of things that give us concern about the formation of a holding company and the effect of a holding company formation to – to separate the most profitable assets from the rail operation and what kind of an effect that's going to have on the rail operation. Are you familiar with any of these economic arguments?

MR. GRIFFIN: We haven't done any work on holding companies at all at the Institute. All I do know is that, you know, it's not a new idea. The UP has done it, the Santa Fe, the Southern Pacific. The Southern has not, I do not believe. They are still a railroad company, I believe. The Chessie System, I think, has a – of course, the Chicago Northwestern did and then – and then it did sell off the railroad part to its employees. And there was a lot of criticism at the time that they had bled the assets out of the holding – out of the railroad and then sold it. So it's – the only thing I do know about it is it is not new and it is certainly not a new argument that the final result may not be what you are speculating about there.

MR. HARING: One point I would like to make, you began by talking just a minute ago about recent legislation, specifically the Staggers Act. My understanding of the Staggers Act is that it was premised on the capital short-fall that the railroad industry is being faced with right now. And Congress's solution to that was to allow the railroads more flexibility, let them cut costs and increase revenues wherever possible. But the basic premise, again, is the capital short-fall in the industry. And I think that given the capital base that the Burlington Northern has available in its – in its land-grant resources, that the Burlington Northern is a special situation and –

MR. GRIFFIN: It appears contradictory.

MR. HARING: It appears contradictory.

MR. GRIFFIN: There is no question in my mind that that's what it was passed for. They said – look at the Milwaukee Railroad, look at the Rock Island. Those are the ones that went under, the ones that were on shaky ground, the ICG, the CN&W, so –

COMMISSIONER CONRAD: Was the Milwaukee – that was a holding company?

MR. GRIFFIN: The Milwaukee was a holding company, but it was a – to my knowledge, their assets other than their transportation were very limited, so that they really didn't have the – they formed a holding company, but they really probably didn't have that much reason to form one is what I am saying, because they didn't have the large assets. Their biggest asset was their transportation plant.

COMMISSIONER CONRAD: Let's go off the record.

(A discussion was had off the record.)

(Recessed at 2:30 p.m. until 3:45 p.m., the same day.)

COMMISSIONER CONRAD: Why don't we start. And would you identify yourself for the record.

MR. FOGARTY: Okay. My name is Bill Fogarty. I am Administrator of the Transportation Division of the Montana Department of Commerce. I appreciate the opportunity to be here today.

Over a brief period of about two decades, from 1850 to 1871, approximately 223 million acres of federal and state lands were granted to the railroad companies to "encourage and assist in railroad construction". The railroads receiving these land grants built approximately 1800 miles of road which was less than 8% of the total railroad mileage of the country. A total of 174 million acres of land came from the federal public domain, either directly or by grants channeled through the state for the specific purpose of supporting the proposed rail lines. Federal grants of approximately 35 million acres were revoked or forfeited before the end of the nineteenth century because of failure to build or complete the roads as specified.

The railroads comprising four present-day railroad systems, all in the west, received 88% of the 128 million acres of federal land. These four systems are the Burlington Northern, the Southern Pacific, the Union Pacific and the Sante Fe. The roads making up the present Burlington Northern, successor to the Northern Pacific, which alone received some 40 million acres, accounts for about 35% of the total federal lands granted to all railroads.

The grants covered various portions of various states and lessor portions of others. In Montana, this amounted to approximately 16% of the total state was given to the railroads in the form of land grants. Approximately 24% of the land area of North Dakota was given to the railroads. The land grants noted above were in addition to the public lands conveyed for use in right-of-way construction itself and consisted of blocks of between 6 and 20 square miles alternating in a checker-board fashion along the railroad lines.

Most of the land grants were subject to a provision excluding mineral bearing lands. However, exempted from this exclusion were lands containing coal and iron reserves, presumably because of the connection of those commodities with the needs of the railroad construction and operation. The exemption of coal lands from the mineral lands exclusion was to prove extremely beneficial to such railroads as the Northern Pacific, which is now the Burlington Northern, the Union Pacific, and the Sante Fe because of the enormous coal reserves in their land grants.

The history of railroad land grants is replete with controversies arising from railroad failures to comply with the terms of the grants, government efforts to recapture granted lands because of such failures, the determination of the railroads to enforce their right in the face of settler's claims and Indian treaties and recurrent allegations of exploitations, misrepresentation and fraud.

The railroads have indicated that the grants of land that they received from the public domain should not be counted in any comparison with federal aids to the various modes of transportation because the government was repaid for these lands through rate concessions required by the terms of the land grant statutes on government traffic carried by the railroads.

Most of the land grants contained provisions under which the government was to be entitled – without time limitation – to rate concessions for the movement of government freight and passenger traffic over the lines built with the aid of these grants. (Editors note: One of the exceptions to this general policy was the Union Pacific land grant of 1862, where no rate concession was required.) These provisions took on a variety of forms, the most common of which, following the pattern established in 1850 with the Illinois Central's grant, required that the railroad receiving the grant "Shall be, and remain, a public highway for the use of the government of the United States free from all toll or other charge, for transportation of any property or troops of the United States." The court later fixed 50% of the regular commercial fare as a proper rate to be paid by the government of the Supreme Court formula.

In 1940, Congress repealed the requirement of the land-grant rail rate reductions on the movement of mail and "civil" property of the government. The rate concessions were maintained, however, for transport of troops and military freight. As a condition of the government's partially giving up the right to statutory rate concessions on land-grant routes, the 1940 act required that the land grant railroads release any claims upon such portions of their grants, as, for one reason or another, still remained unpatented despite the lapse of 70 years or more from the time of the initial grants.

In 1946, the remaining right to land-grant rate concessions for the government on movement of military property came to an end; the railroads were not required to give up anything in exchange for the surrender of the government's right to these concessions.

The argument of the railroad industry that the value of the land grant concessions made by the railroads to the government exceeded the value of the land grants received by the railroad from the government is subject to question.

1. The railroad may understate the value of the granted lands to the railroads in comparison with the value of the rate concessions made by the railroads.

2. It may ignore the policy of the Interstate Commerce Commission in regulating rates to compensate for reduced rate levels on government traffic by means of higher rate levels on other traffic. It may, in fact, overlook the fact that the government had an unqualified contractual right to receive the benefit of the land-grant rate concessions in perpetuity.

3. It neglects to mention that even government officials recommended final repeal of the land-grant rates, but recommended also that such repeal should be accompanied by return to the government of such granted lands other than the right-of-way which were still in the hands of the railroad.

4. The basic position of the railroad industry with respect to the value of lands received under the land grant program was initially that the value of the lands granted to the railroad was not more than the top price at which the government was offering to sell the land — for the most part without success — in the states where the land grants were being made.

5. The price at which the government was selling the land is, of course, an inaccurate reflection of the benefits received by the railroads from their extensive grants. As students of American economic history indicate "Their seems to be little question that what the railroad was primarily interested in was the potential value of the grants. In fact, they confidently and as it turned out, correctly, expected to realize the sum far in excess of the current value of the back-country lands." (Editor's note: This quote was from David M. Ellis's, "Comments on "The Land Grant Legend In American History Tests" ".)

As was intended, the potential value of the land grants was a vital factor in attracting the substantial amounts of railroad capital needed to finance construction of the lines.

In their campaign for repeal of the land-grant reduction, the railroad repeatedly argued — and the argument was echoed by the supporters of the repeal — that the rate concessions to the government were necessarily reflected at higher rates to other shippers so that repeal of the concessions would result in holding down rates charged to the public generally.

The logical implications of this line of argument dictate the conclusion that the land-grant rate concessions, no matter how they are figured, were primarily a burden on the general shipping public from which they were recouped rather than on the railroads.

One could conclude then that the repeal of the land-grant rates would not result in increased income to the railroads, but, rather, in reduced rates to the shippers generally. That, in fact, did not happen.

It is difficult to get a value today on the grant-lands currently held by the railroads.

There is no question however that the formation of holding companies such as the Burlington Northern has recently completed in transferring of assets to those companies which have been carried on the books of the railroads will be in the hundreds of millions of dollars.

The Burlington Northern is a successor to the Northern Pacific Railroad, which was a recipient of the largest land grants made to any of the railroads. Over 40 million acres went to the Northern Pacific with another 7 million going to the Great Northern and the Chicago, Burlington and Quincy. The Burlington Northern owns about 2.4 million acres today and the bulk of it is derived from the land grants. Approximately 1.5 million acres is in timberlands in the western states and the Burlington Northern owns mineral rights on approximately 6 million acres, including 5 million on which it owns all of the mineral rights and one million on which it owns coal and iron rights only.

Although the estimates are hard to come by, it is estimated that the Burlington Northern owns somewhere around 15 billion tons of reserves of low-sulphur coal considered by the company as being economically mineable and about 7-10 billion tons of which are under lease. There may be as much as 50 billion tons of coal which may lie under unproven reserves under the BN lands. No coal company in the United States matches the Burlington Northern's reserves. In 1978, coal production totaled about 16 million tons and the tonnage has increased steadily since then.

The land-grants form a substantial part of the benefits which the railroads receive from the government. Aside from the vital role of the lands in getting the construction of the major portions of the railroad system in the west, it opened up the vast areas of the country to settlement. The land grants of course also help the railroads with substantial operating funds and provided major sources of revenue. It is not clear that the railroads ever repaid the government for the railroad rate concessions on government traffic and in fact it's clear that they did not come close to offsetting the benefits received by the railroads from the grants. Comparisons made by the railroad industry greatly overstate the extent of the concessions made by the land grant railroads themselves and usually omit numerous relevant factors, and fail to place the rate concessions made by the railroads and the land-grant benefits received by them on an actuarily comparable basis.

It is conceivable that an inquiry should be launched into the broader issue of these land grants to insure that the land grants will continue to be used in the public interest rather than for private sector gain.

This concludes my prepared testimony.

COMMISSIONER CONRAD: Thank you very much. You've provided some very interesting testimony. And there are a couple of things I would like to follow up. One is, are you aware of whether or not the Northern Pacific was required to make rate concessions as part of their land grant?

MR. FOGARTY: I think they were. As I understood it, the only one that was exempt from that was the Illinois Central at first and then I think that they, basically, all fell into line when the Supreme Court made that decision that fifty percent of the rate was to be charged.

COMMISSIONER CONRAD: What year was that Supreme Court decision made?

MR. FOGARTY: It is in my testimony, Mr. Commissioner. I would have to look back there to see.

COMMISSIONER CONRAD: You made a series of very interesting points on the question of the capitalization that has been made to substantiate the claim made by the railroad that they have, in fact, paid for everything they have received. No doubt, you are familiar with that argument. They have made it time after time here in North Dakota. I have got clippings here that – have you got the one – here's one quoting Mr. Charles Bryan, BN Vice President, in the Minot Daily News of September 19, 1981. "Next, I want to emphasize that the government never gave land to the railroads. The railroad companies earned the land. It was a contractual relationship in which a railroad company had to build a line and put it into operation to earn title to the government lands. Of course, back then, almost all of those lands were considered to be nearly worthless before a railroad was built through them." It goes on to say that railroads receiving land grants were further required to provide half fare to the Government for almost a century after receiving the lands. Both Congress and the Federal courts long ago concluded that the railroads repaid the government for the value of the lands they were granted. That is the kind of argument that we see repeatedly in North Dakota. I am sure you see the same argument repeatedly in Montana. And it seems to me what you have indicated in the five points that you made in your testimony is that the calculation that the Government made and that the railroad still pushes – that determined that they had – had given rate concessions in excess of the value of what they were given – you may have some problems with it. And in your best judgment, do you find that to be the case? Do you think there are serious problems with those calculations?

MR. FOGARTY: I think there are, certainly, some things open to question. One is that they talk about the value – they base the value of the land that they received on the highest value at the time it was being offered for sale by the Government, which may, in fact, have been fifty cents or a dollar an acre. I am not exactly sure of the figure. But in that value – of course, at that time I don't think anybody perceived the minerals or those kinds of benefits that may ultimately acquire from it. I think there are some questions there.

I guess the big question that we have in Montana is that with the holding company; basically, where they separate, say, the minerals and resources from the railroad itself. There is some question that the land there should be used to support the railroad rather than being a separate entity.

COMMISSIONER CONRAD: Are you aware of whether or not Burlington Northern at this time has, in fact, separated assets from the railroad itself?

MR. FOGARTY: I can't speak to that policy, but it's my understanding I think they have. I think they have. I remember reading some figures that – I think that in their last profit statement that 35 percent of the profits came from their – I think it was from their timber and mineral resources and only six percent of that went back into the railroad. Do you remember that?

COMMISSIONER CONRAD: I know that those elements – those profit centers that are largely as a result of land grant assets; that is, oil and gas, coal, timber and land – those four profit centers account for six percent of the total revenue of the enterprise, but account for 35 percent of the profits.

MR. FOGARTY: Yes.

COMMISSIONER CONRAD: Which may be what you are referring to in that case.

MR. FOGARTY: That's correct, that's what I was referring to.

COMMISSIONER CONRAD: You make the point that the value of the land may be understated because the mineral value may not be fully accounted for. That is a concern that we've heard many times in North Dakota as well. You said, second of all, that they may have generated higher rates on other traffic in order to make up for the rate concessions given the Federal Government and, therefore, the Federal Government rate concessions were not a reduction in net revenue or gross revenue to the railroad but, instead, there was a transference.

Third, you have indicated that as part of the agreement on the ending of rate concessions, that some land was to be returned to the Government, land other than that on the right-of-way.

MR. FOGARTY: As I understood it, it was the feeling of some of the people who agreed with the railroad that these rate concessions should be abandoned. They also indicated at that time that some of the land grants other than the right-of-way should be returned. Of course, it was never done.

COMMISSIONER CONRAD; There is some – there is an interesting question here; and, that is, whether or not, because the Government ended the rate concessions, that means the responsibility of the land grant railroads as a result of the land grants ended as well.

MR. FOGARTY: The responsibility of the land-grant railroads ended as well.

COMMISSIONER CONRAD: Well, what the railroad says – and I've seen them make this argument – that the fact that the Government ended the requirement for rate concessions, they take that to mean that that ended their responsibility as land-grant railroads. And I am not sure it necessarily follows that because the rate concessions ended that all of their responsibilities as land-grant railroads ended as well. What would be your reaction –

MR. FOGARTY: I think that's exactly how they perceived it. I think there is some question on some of the – on the other side as to whether that was what the intent of that Act in 1946 was.

COMMISSIONER CONRAD: To your knowledge, the Act of 1946, does that sepcify anywhere that the railroads have, in fact, paid for what they had received by way of land grants?

MR. FOGARTY: I don't know if it's specifically specified in the Act there. Of course, the argument, as already stated, that the railroads are using is that since they were relieved of that rate concession provision, that that was Congress's concession that they had, in fact, paid back their full dues.

COMMISSIONER CONRAD: Let me ask one other question that has frequently come up. I have a radio broadcast – and, again, in the article which appeared in the Minot Daily News, September 19, 1981, again, Mr. Charles J. Bryan, BN Vice President, says: "Burlington Northern is also being accused of improperly siphoning off the natural resources it holds from land grants to railroads in the 19th century. Let me correct some misconceptions. First, some of the branch lines in North Dakota originally were part of the Great Northern Railway. The Great Northern Railway was not a land-grant railroad."

That same argument has been repeated by Burlington Northern officials in radio interviews that the Great Northern was not a land-grant railroad. To your knowledge, was the Great Northern a land-grant railroad or did it receive from predecessor corporations land-grant assets?

MR. FOGARTY: I can't answer that, Commissioner. I don't know the answer to that.

COMMISSIONER CONRAD: I know that you had – in your testimony, you made the statement that there were some seven million acres of land grants that the Great Northern and one other rail had received.

MR. FOGARTY: Yes. The Great Northern and the Chicago, Burlington and Quincy was the other one.

COMMISSIONER CONRAD: Those two had received some seven million acres, as I recall, from your testimony.

MR. FOGARTY: The statement was that over forty million acres went to the Northern Pacific, with another seven million going to the Great Northern, and Chicago, Burlington and Quincy.

COMMISSIONER CONRAD: I have here a copy of House Document No. 159, 79th Congress, first session, entitled "Public Aids to Domestic Transportation, Letter from the Board of Investigation and Research Transmitting the Report on Public Aids to Domestic Transportation," which you may recall is the basic study which was done on rate concessions and the question of what the rails were given by way of concessions and what they received via the land grants.

On page 110 of that report, "Acreage received by railroads under Federal and State grants," it indicates that the Great Northern is listed as one of the systems and that, in fact, they did receive 2.8 million acres in Federal grants and received 425,000 acres in State grants, exclusively from the State of Minnesota, for a total of 3.2 million acres received via a land grant. So I wanted to have this in the record because, repeatedly, we hear Burlington Northern making the assertion that Great Northern, which is one of the predecessor companies, along with Northern Pacific, to the Burlington Northern was not a land-grant railroad. And the facts I have indicate that, in fact, it was a land-grant railroad and, in fact, received both land from the State of Minnesota and the Federal Government.

MR. FOGARTY: Our figures would indicate that, too.

COMMISSIONER CONRAD: There are two major issues that it seems to me we run across repeatedly. One is the question of formation of the holding company. No. 1, does the formation of a holding company adversely affect rail operation? Question No. 1. Question No. 2: Will the formation of a holding company adversely affect branch line abandonment? I am wondering if you would comment on either or both of those questions.

MR. FOGARTY: We are currently, in the Division of Transportation, taking a look at, first of all, the intent of the land-grant law to determine if, in fact, the land grants were to – it was the intent of Congress for the land grants to be used to help support the viability of the railroads. At this point in time, we have not made that – a clear determination on that.

It's our feeling, I guess right now, that it could have a dilatorious effect. I don't think we have proven anything beyond a doubt at this point that it will, but we are certainly concerned about it and we're also concerned that it may have an effect on some of the branch line abandonments because of the railroad's inability to maintain those; where, if the mineral resources and some of the other land resources were used to support the railroad, that then these could be maintained as viable branch lines.

COMMISSIONER CONRAD: Are you familiar with the letter that went from Mr. Bruce Hatton, Director of Governmental Affairs for the ICC, in May of this year, to your United States Senator, Senator Max Baucus? Have you ever seen a copy of that letter?

MR. FOGARTY: I have heard about it, but I haven't seen a copy of the letter.

COMMISSIONER CONRAD: The letter goes directly to the issue, I think, of whether or not separating off the non-rail assets from the rail operation will have an adverse effect. I just share with you, on page three of that letter – I quote: "Non-rail income, primarily from natural resources, is extremely important to BN because it has enabled BN to maintain an A credit rating on its bonds by Moody's Investor Service. Any lower rating would have made it extremely difficult for the company to have done any non-equipment financing." Of course, most of the non-equipment financing or equipment financing is done through the trust – equipment trust.

The letter goes on to say, "For example, during the five years 1976 throuh 1980 the combined earnings available to cover fixed charges totaled $1,059 million. Fixed charges over the same five-year period totaled $365 million, for a fixed charge coverage ratio of 2.9. Coverage of this magnitude is satisfactory to maintain an A rating. However, if non-railroad income is deducted from earnings available for fixed charges, the $1,059 million figure would be reduced by $774 million to 286 million, or less than the total fixed charges of $365 million. Rail operations performed better in 1980, generating a fixed charge coverage ratio of 1.30, but that ratio would not have supported an A rating. Additionally, the improved rail earnings might not have been possible without the large investments in rail facilities financed in part by funds from natural resources and from outside financing permitted by the A rating partly attributable to natural resource income."

It seems to me that that is some indication that any move to split resource income from land-grant assets off from the rail operation will have an adverse effect on the rail operation. I share that with you because I think it's something that might be of interest to you.

MR. FOGARTY: I have seen some excerpts from that letter, Mr. Commissioner. We are faced with many of the same problems in Montana, many of the same ones you have here in North Dakota.

COMMISSIONER CONRAD: Could you outline for us what the status is of Montana's review of this problem and what Montana – what avenues Montana is exploring to deal with this problem?

MR. FOGARTY: You're talking about, primarily, the holding company aspect now? At this point in time, within the – Montana has adopted no policy on it formally. The Division of Transportation is currently looking into the areas that I mentioned before, if it was the intent of the Land Grant Act to use the mineral and other land resources in order to maintain the viability of the railroad. It's – I think, from what my attorneys tell us, that it's probably going to take in the neighborhood of a year before we have a clear-cut idea and enough background on that particular case to decide if we're going to pursue it or not.

It's of enough concern to us now that we are dedicating considerable manpower in the Division into looking at it.

COMMISSIONER CONRAD: Have you done any studies in the State of Montana that might indicate the effect of branch line abandonment on your State, increased costs to the taxpayers of the State of Montana as a result of branch line abandonment; and, specifically, the increased costs that would be borne by your taxpayers as a result of the movement of heavy volumes off of the railroads and onto the roads?

MR. FOGARTY: I can't tell you of any specific study. There are some – I guess there are some studies that relate to that that I know of, where they indicated that the tax loss, because of the abandonments that would occur and, also, because of the impacts of grain subterminals, which, of course, Burlington Northern is promoting and we're looking at, are very concerned about the large economic dislocation that this will have on the small communities and the tax loss from the branch line abandonment, also the impact upon our highway systems.

There was a study done by the State of Montana that had to do with terminals. It has not been released yet and it was not a policy study, it was just something we are going to use as far as developing our policy on subterminals. It talked about the severe economic impact that these grain subterminals were causing, particularly on the line – branch line abandonments, particularly upon our primary and secondary roads, not so much upon our interstate highway systems.

COMMISSIONER CONRAD: Are you familiar at all with a study that was done by the Justice Department that is entitled "Competition in the Coal Industry," reported by the U.S. Department of Justice?

MR. FOGARTY: No, sir.

COMMISSIONER CONRAD: I would bring this to your attention as well, because I think it's a very important study, dated November of 1980, "Report of the U.S. Department of Justice, Pursuant to Section 8 of the Federal Coal Leasing Amendments Act of 1976 for Fiscal Year 1979." And in this study, in testimony by the Department of Justice before a Congressional Committee on September 11, of 1981, they say, in reference to the report, "We concluded that leasing Federal coal reserves to common carrier railroads could have anticompetitive effects only under certain circumstances." And the certain circumstances, I think, are very interesting. "If a railroad with market power over the transportation of coal in particular markets also owned substantial coal reserves in those markets, it could find it profitable to drive up the price of coal by withholding coal transportation services. Monopoly profits that might otherwise be unattainable because of ICC regulation of transportation rates might thus be collected through coal operations."

And, of course, it seems to me that Burlington Northern fits perfectly the concern being registered with the Department of Justice on the adverse effect on competition in the coal industry if, in fact, we would have a situation in which Burlington Northern would find itself able to engage in the coal business with the very substantial coal reserves which you have outlined in your testimony.

I would go on to point out further the letter – or the testimony which was provided by the Justice Department. It says, "Only one railroad originating coal in the West, the Burlington Northern, was found to have a significant degree of market power. Consequently, we believe that only the Burlington Northern might have an incentive to act anticompetitively if Federal coal leases were issued to it. Even in the case of Burlington Northern, not every coal lease issuance would necessarily create competitive problems." The point I think we're making here is that there may be a very serious problem when you couple Burlington Northern's extensive coal reserves and coal resources with their monopoly transportation. And the fact that they have a holding company, as I understand it, may free them from certain ICC restrictions on coal development. I don't know if you are familiar with it.

MR. FOGARTY: That's our understanding, too. That's another concern of the holding companies we have, because we understand, now, that they can go ahead and market their coal and transport their own coal.

COMMISSIONER CONRAD: That may be the sleeping giant in all of this, the fact that they have these enormous resources in North Dakota and Montana of coal and, of course, in the Powder River Basin as well. And you couple that with a monopoly on the transportation of that resource and we may be building a power in the coal industry that would simply have no rival; and that may have, as this report, I think, quite clearly points out, very serious ramifications for the competitive position of others in the coal industry. But that is your understanding as well, that their formation of a holding company would put them in a position to enable them to engage in the coal business and avoid the restrictions that the ICC would have on them as a rail?

MR. FOGARTY: That is our understanding at this time. Of course, the other concern that we have now is with the ICC, if they approve the abandonment of the Minnesota to Miles City route. And in talking to some of the people in South Dakota, I understand that the Burlington Northern is very likely to end up with the ownership of the Milwaukee line down there or else the State of South Dakota may well buy it and lease it back as far as the operation to the Burlington Northern. That would further complicate the issue.

COMMISSIONER CONRAD: Anything that you would want to add, anything that you would like to add?

MR. FOGARTY: I think one thing I would like to point out – I am not sure if this is the case here. In Montana, Burlington Northern is, unquestionably, a monopoly. There is just no other system to compete with it. We have no railroad system. They control the trucks by their rate structure. We are very concerned with the problem over there.

MR. HARING: This brings up an interesting point. We had earlier testimony today from a – from some transportation experts here in North Dakota that discussed the market power of Burlington Northern in this State and discussed the changing – changing environment of the railroad system. And they talked a little bit about the Staggers Deregulation Act. And it seems that the basic – what the Staggers Act did was give the railroads a lot more flexibility in setting – in setting rates, that they could cut their costs by abandoning the branch lines and increase their rates, but it was all premised – it's all premised on greater competition in transportation. But in North Dakota and Montana, there is a special – a special situation that exists. There isn't any meaningful water transportation.

And they did go on to say exactly the same point that you just made, that the railroads can actually control the costs of the trucking – have an impact on the costs of the trucking industry. I guess the point to be made here is that, you know, this great change in the railroad regulation that's come about with the passage of the Staggers Act is premised on the capital shortage in the rail industry. There is just no money to build and maintain the lines. And the Burlington Northern, I think, should possibly be considered exempt from that problem because of their vast mineral and land wealth. Is that the conclusion that you have come to?

MR. FOGARTY: In the freight movement data that the State of Montana acquires from the elevators, it was very clear that you could see the fluctuation in the truck traffic or in the truck hauls that were going to the West Coast by the direct relationship with the rail rates. And I think, in a two-month period, the truck haul fluctuated by nine percent. And it was almost directly attributable – it was directly attributable to the adjustment in the rail rates.

COMMISSIONER CONRAD: I'd just ask one further question on the land grant to the Northern Pacific, which, of course, is the predecessor of the Burlington Northern. It says – and I quote – "That it will be and hereby is granted to the Northern Pacific railroad company, its successors and assigns for the purpose of aiding in the construction of said railroad and telegraph line to the Pacific Coast and to secure the safe and speedy transportation of the mails, troops, munitions of wars and public stores over the route of said line of railway." And it goes on, of course, to give the grants. And it seems to me that that language would indicate that there was more than a requirement simply to construct the railroad and telegraph line, that the intent went beyond that when it says, "and to secure the safe and speedy transportation of mails, troops, munitions of war and public stores over the route of said line." And that, of course, is a central question here, because the railroad asserts that, really, what was at work here was a construction loan. We have this language in any number of their arguments across the State of North Dakota, that the land grants were merely a construction loan; and once they had built the main line to the Pacific Coast, they had met the terms of the agreement and, thereafter, their responsibility ended to the public which had granted them these assets. I don't know what you're reading of that section would be, but it would seem to me that it extends simply beyond building a line to the Coast.

MR. FOGARTY: Those are the kind of things we were looking into to decide if we want to file a case on the holding company.

COMMISSIONER CONRAD: Okay. Anything else that – if not, we want to thank you very much for your testimony and invite you to be present tomorrow. I think we're going to have a very interesting lineup tomorrow of witnesses.

MR. FOGARTY: We would also be very interested in maintaining a continuing dialogue with you on the problem. And if there are some things we can pursue in a joint effort, Montana would be very interested in doing that.

COMMISSIONER CONRAD: We are very interested in doing that. We have already talked to Representative Shontz about sharing with the State of Montana the transcript that will come out of these hearings.

And, hopefully, that will provide a strong basis of factual information, a common basis, for all of us to use in pursuing this matter which, I think both of us recognize, is of great importance to our individual states. So, again, I thank you very much for your testimony.

MR FOGARTY: Thank you for the invitation.

(The hearing was recessed at 4:30 p.m., the same day.)

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(The following proceedings were herein continued, commencing at 1:00 p.m., Thursday, October 1, 1981:)

COMMISSIONER CONRAD: We will start this afternoon's proceeding. We'll give people a couple of minutes here to take their seat and then we'll proceed. We do have a very full schedule this afternoon of witnesses to give testimony. And once we begin, we're going to want to proceed very quickly so that all of those who have asked for an opportunity to testify will have that chance.

First, I want to welcome all of you to this hearing entitled "Burlington Northern and its continuing responsibilities as a land grant railroad."

There are serious questions which have arisen in our State on the effect on North Dakota of Burlington Northern's decision to form a holding company; the effect of that decision on branch line abandonment and the effect of branch line abandonment on our State. I, of course, as State Tax Commissioner, am especially concerned about the effects on the tax base of our State. We have heard conflicting claims from both sides on this issue.

Some of the key questions are, No. 1: Will a holding company structure hurt the rail operation? The railroad, for their part says, No. I would cite a clipping which appeared in the Bismarck Tribune, September 29th of this year. And I quote: "The BN officials said forming a holding company, which has been criticized for separating the railroad's land and mineral interests from the railroad operations, won't have any adverse effects on railroad service. They said it was done as the only practical means of being free to raise capital to develop the railroad's resources."

There are other views, including a report that was issued by the ICC, entitled "Railroad Conglomerates & Other Corporate Structures." And that record – and I quote, it says, "Our concern lies in the fact that railroad noncarrier resources and income have been divorced from the railroads in many, if not most, cases without adequate compensation.

As a result, while the stockholder has lost nothing and perhaps has even gained in terms of equity and earnings, the railroad as an instrument of public service has been deprived of wealth accumulated over many years, including resources such as land grants provided at public expense."

A second question is: Has the railroad paid for the assets it has received? Again, the railroad has one view. It indicates that they have paid for the assets that it has received. And I quote from a Mr. Charles Bryan, Vice President and General Manager of BN's Twin Cities Region. In the Fargo Forum of August 20, 1981, Mr. Bryan says, "I do know that the land grant railroads have shown again and again that they more than repaid the government for those lands. The railroads did that over many decades by carrying government troops and government material for half the going rate. During all those decades, the railroads also carried U.S. mail at reduced rates. The last of those low rates for the government did not end until 1946." Again, there are alternate views.

And I would quote from the "Public Aids to Domestic Transportation," which is House of Representative's Document No. 159, the Letter from the Board of Investigation and Research, which is the hearing that made a judgment as to whether or not there should be reduced rate requirements continued for the railroads or whether or not those rate concessions could terminate.

And in a separate opinion of Mr. C. E. Childe, who is a member of the Board, he says – and I quote – "On much of the Government traffic, however, the savings are more apparent than real, because the published tariff charges, especially on ordnance and military supplies, are so high in relation to general levels of carload freight charges, that the amount of revenue left to the railroads after making land-grant deductions represents a charge greatly in excess of average."

A third question we have to answer is: Does the railroad intend to separate land-grant assets from the railroad itself? Mr. Mcleod, the Dirctor of Branch Line Management, in response to a question I asked at the Public Service Commission's open meeting, expressed the view that there was not going to be a shifting of land-grant assets away from the railroad. A proxy statement sent to Burlington Northern stockholders indicates something quite different. And I would quote from that proxy statement sent to Burlington Northern stockholders. "Management believes that development of the railroad's natural resources and nonrailroad properties could be facilitated if transferred to the holding company or other subsidiaries of the holding company. If formation of the holding company is approved by the stockholders, it is likely that some of these resources and properties will be transferred to the holding company; although, the extent of such transfers may be limited because of tax considerations. Transfers of railroad's natural resource properties may also be limited by certain of railroad's mortgages which constitute liens on such properties to secure bonds issued by one of the railroad's predecessors."

A fourth question is whether or not the holding company move will place Burlington Northern in a position to be anticompetitive in terms of development of coal resources in North Dakota and in this region. Those are the broad sorts of questions that require answers. And, of course, there are other questions that we will want to answer as we go along as well.

The railroad, I think, should expect such scrutiny. I would remind them of the old adage, "To whom much is given, much is expected." And the railroads, specifically Burlington Northern's predecessors, have been given a great deal. In North Dakota, they were given 10.7 million acres, which is nearly a quarter of this entire State. They still retain 1.1 million mineral acres, making them the largest mineral interest owner in the State of North Dakota, next to the Federal Government.

There are other assets which are held by the railroad, not the least of which is their coal resources — reserves of 14.7 billion tons; and, also, dramatic resources in terms of holdings in oil and natural gas.

Let me just conclude by saying that these are the kinds of questions we hope to answer. We think the outcome of the decision is critical. It affects our farmers, our businessmen, our railroad workers and the tax base of our State. And so with that, we would open the hearing and call the first witness, who is Representative Jim Brokaw, member of the North Dakota House of Representatives, who has just come from a five-state meeting of legislators, who has a resolution that was passed at that meeting to share with us, to put on the record.

Let me make one further observation as Mr. Brokaw readies himself; and, that is, that the purpose of this hearing is to seek answers to those questions and is to establish a record on these questions. United States Senator Max Baucus of Montana has requested a transcript of this hearing. The State of Montana has requested a transcript of this hearing. People in Minnesota have requested a transcript of this hearing. People in other parts of this region have also requested a transcript. So what we hope to do here is establish a record and try to factually ascertain the answers to the questions that we have raised.

With that, I proceed with Mr. Brokaw.

REPRESENTATIVE JAMES BROKAW: Commissioner Conrad, ladies and gentlemen: I do come to you as an elected official out of District 28. And I can only tell you that we are concerned down in there about railroad abandonment. Our little home town of Forbes has already lost its railroad.

I didn't think, for instance, right in the area — in a town like that, a town like Ellendale, would lose the railroad. They have lost one railroad, have very limited service from another. And it goes on and on. And right up north, in Edgeley, they, too, have very limited service. And where this is going to stop and what effect it's going to have, I really don't know all the answers to that.

But I did just come back from the Five-State Legislative Conference at Rapid City that was held on the 27th and the 29th. And that consisted of the States of Montana, Wyoming, South Dakota, Nebraska and North Dakota. And our delegation there introduced this resolution. And I might say that it was passed unanimously. And I would like to have it put on the record. And the resolution reads as follows:

"WHEREAS, certain United States railroads received a total of 128,000,000 acres of federal land to encourage and assist in railroad construction; and

WHEREAS, the total land grants enjoyed by the railroad displaces 9.3 percent of the total land area of the United States, exclusive of Alaska and Hawaii; and

WHEREAS, the railroads receiving these land grants built about 18,000 miles of roadway, approximately eight percent of the total railroad mileage of the country; and

WHEREAS, four major western railroads, the Burlington Northern (through the Northern Pacific), the Union Pacific, the Southern Pacific, and the Sante Fe received 88 percent of the 128,000,000 acres; and

WHEREAS, the land grant railroads have retained ownership of some land and much of the mineral rights obtained through said land grants; and

WHEREAS, said land and mineral rights are extremely valuable and they contain farmland, coal, oil, gas, timber, and other resources; and

WHEREAS, the land grant railroads derive significant income from such land and mineral rights; and

WHEREAS, the land grant railroads have also formed holding companies to separate the land, mineral, and natural resource assets form their railroad operations; and

WHEREAS, the railroads (particularly Burlington Northern) have announced intentions to abandon a significant portion of branch line networks in the next few years; and

WHEREAS, rail transportation is vitally necessary to rural states to gather and ship bulk agricultural and other commodities; and

WHEREAS, the abandonment of branch lines will result in a shift in fiscal responsibilities from the private sector to the public sector to maintain a road and highway system;

NOW, THEREFORE, BE IT RESOLVED that the Five-State Legislative Conference and the respective state legislative branches of government in the five member states develop a cooperative effort to influence the retention of a sound railroad network by the land grant railroads and an efficient and economical operation of this system and the benefit of the citizens of those states; and

BE IT FURTHER RESOLVED that the Five-State Legislative Conference request that the United States Congress institute an investigation to accomplish the following:

- Determine the value of the remaining land grant assets currently held by the railroads.
- Determine the current income from land grant assets.
- Determine the extent to which railroads require support of income from land grant assets to maintain and improve services, now and in the future.
- Determine extent to which the Interstate Commerce Commission should permit necessary rail services to be abandoned in the light of government-provided land grant assets.
- Establish a policy on diversion of land grant assets from "railroad" purposes.
- Establish a policy that government-provided land grant assets and income from such assets should be included in the Interstate Commerce Commission determination of adequacy of revenues and earnings of the land grant railroads.
- Examine the extent to which land grant assets and income should be used to replace government subsidy of necessary connecting services to land grant railroads; and

BE IT FURTHER RESOLVED that a copy of this resolution be sent to each member of the Congressional Delegation of the member states of the Five-State Legislative Conference and to the heads of the appropriate federal agencies."

This resolution was presented down there and was passed unanimously and I wholehartedly support it. I think, probably, the railroads have been somewhat like a child that you have given everything to over the years and then you suddenly wonder why you are getting kicked in the shins. I think you have to take drastic measures to straighten that out sometime.

I thank you for the opportunity to appear before your committee here.

COMMISSIONER CONRAD: Representative Brokaw, could you provide us with a list of the states that were represented at that meeting?

REPRESENTATIVE BROKAW: Yes. I have copies of these that I can give you. They were Wyoming, Montana, Nebraska, South Dakota and North Dakota at this conference.

COMMISSIONER CONRAD: Thank you very much for providing us with that resolution.

Next we will hear from Representative Shontz, Chairman of the Interim Transportation Committee from the State of Montana.

REPRESENTATIVE SHONTZ: Mr. Conrad, ladies and gentlemen, on behalf of the people of Montana House District 53, I want to extend my thanks for the invitation to be here today.

I see several major challenges being put forth by the Burlington Northern Railroad. The first is the restructuring of the company into several holding companies. The second is the proposed abandonment of 8,066 miles of branch lines in fourteen states. The third is the unit train subterminal concept. The fourth is the property tax protests being put forth by the railroad. The fifth and, perhaps, the most critical is the attitude of the Burlington Northern towards the people of our region.

How should these issues be addressed? I don't come here with all the solutions, all the answers, but I can say this, whatever we do, we must do together. If I can leave you with one thought today, it is that we confront our rail concerns as a unit of people and states. Let us present a united front as we deal with one of America's corporate giants, not just one or two or even ten states and their citizens working together, but all states the BN serves and their millions of citizens.

Let's reflect for a moment on the history of the railroads in our part of America, truly the breadbasket of the world. In the latter portion of the 19th century, Congress handed over to the railroads as a subsidy and incentive to cross the Great Plains, the Rocky Mountains and connect California to the East. Four of the railroads received 111 million acres of land. The Northern Pacific received 47 million acres. The railroad brought millions of people to the West, who farmed the land, cut the timbers and mined the minerals.

Other railroads benefited from the 1862 Congressional approval of the Homestead Act. Millions of acres of free land provided the incentive for construction of the Great Northern, Milwaukee and the Chicago, Northwestern railroads and the development of agricultural lands along those lines. After the initial settlement rush came, if I may, the farmer-railroad war began, accompanied by the Granger movement, the Non-partisan League, et cetera. I wonder if we are not facing a rehash of that war in our states in 1981.

The cornerstone of our great free enterprise system is competition. Let's look at the competition among the railroads across the northern tier. The Soo Line is still there. Thank you, Soo Line. The Chicago, Northwestern railroad moved its assets out of the railroad into other areas of capital venture. Several years ago, it sold a depleted railroad to its employees. In a shrunken form, the employee line – excuse me, the employee-owned line is surviving. The original railroad company is now manufacturing Acme boots, among other things.

The Milwaukee road formed several holding companies a number of years ago. Revenue from rail operations was used to invest in other ventures. Today, the railroad is bankrupt and in a shrunken state. Yet, the parent company, the Chicago, Milwaukee and St. Paul, is a major investment participant in the Northern Tier pipeline project.

The Great Northern, the Northern Pacific and the Burlington railroads combined to form the Burlington Northern. While there were six roads, there are now two, one of which is a giant. In Montana, there is really one. And I wonder if the BN is not, in fact, a transportation monopoly in Montana – and also in North Dakota – and should be regulated as such.

Now, why do I say a monopoly? Apologists for the railroad will claim trucks provide lively competition. I say, that's nonsense. When one company, such as the BN can literally force massive changes in the marketing structure of the upper Midwest's agricultural industry, that hints of monopoly. The railroad is not responding to market changes with proposed branch line abandonment and unit train pricing. It is, in fact, creating those marketing changes. The agricultural community at this point is captive and must conform to the wishes of the railroad. I ask you: Is that not monopolistic? Before this controversy is settled, we may be looking for a good trustbusting President, like Republican Teddy Roosevelt or his cousin, FDR.

Now, to those specific challenges we face regarding holding companies, I am pleased to report that 120 legislators from the States of South Dakota, North Dakota, Nebraska, Wyoming and Montana completed a meeting the day before yesterday on transportation in Rapid City. That group has asked Congress to inventory the holdings of the BN, not just rail holdings, but land, minerals and other resources, such as timber granted by the government to subsidize rail operations 114 years ago. I question whether the Burlington Northern should be allowed to keep those resources if they are not going to be used to fulfill their original intent; namely, to subsidize main line and branch line railroad operations.

Secondly, branch line abandonment. Apologists for the BN will be asking that the railroad be permitted to abandon branch lines because they are not profitable, they cost too much to rebuild. Profit is often an accounting procedure. In instances where the line is not profitable, the profit from land-grant resources should be used to maintain and operate the lines. That's again why the BN was subsidized with 47 million acres of real estate and raw material wealth in the first place.

Unit trains. If they are cost-effective, a good idea, to a point. Who will build the terminals and pay for the accompanying trackage? I believe the grain dealers and associations. I notice the BN has excluded itself from capital risk in permanent project investments here. Apologists for the BN claim highway impacts will be less and shipping costs will be lower for producers. Well, there may be less truck traffic on the interstate system, but there will be much more truck traffic on our primary and secondary systems. As we all know, the latter two are deteriorating much faster than we can afford to repair them.

Just a note about the grain trucking industry. Hang tough, folks, because we desparately need you. Even if you can't keep the BN competitively honest, your importance to grain marketing and transportation must not, should not and, hopefully, will not diminish.

If branch line abandonment accompanies unit train usage, producers will pay more than they do now for transportation of their product. How much I do not know. I am afraid to guess.

The Burlington Northern was assessed approximately eight million dollars in local property taxes. Of the eight million dollars, it is protesting 6.5 million dollars. That's revenue being lost to local governments, not necessarily to the State of Montana. The State of Montana, through the courts, is pursuing a new method – a new system of taxing or assessing the Burlington Northern property. In the past, states have assessed railroads and utilities through a common and central system. Now, the State of Montana is going to take an inventory of the property of the Burlington Northern in the State of Montana. And initial indications are that the salvage of that property alone will be three times what the assessed value is currently.

Finally, I want to address the BN's attitude toward the people of our states. I want to extend my thanks to the Burlington Northern for the promotional effort it is carrying on. In my opinion, the railroad has shown it has learned nothing in the last hundred years about the people it serves. I find the smaltz personally insulting. As a matter of fact, that ad campaign has done more to crystalize negative opinion toward the BN than just about anything else it has done the past ten years. It is, indeed, uniting rural America. In a way, I'm glad the railroad has shown it still thinks we're a gullable bunch. If the great issue is, who controls our destiny, this time we will stand ready to assure that we, the farmer, the rancher, the laborer, the small business owner, does, not the Burlington Northern.

Defiant words, perhaps, but let us remember, history is a very good teacher. The attitude of the railroad toward the people of Montana and North Dakota hasn't changed, as I said, over the past one hundred years. Together, let us remind the railroad that along with monopoly comes stringent public regulation, that along with subsidy comes service, and that any corporation is but one citizen among many, not one standing apart or above. Together, we must determine our own future as individuals. Whatever we decide, we must decide together, be it in Congress or elsewhere. Thank you.

COMMISSIONER CONRAD: Thank you very much, Representative Shontz.

As Chairman of the Interim Legislative Committee for the State of Montana, I am wondering whether or not you have pursued possible approaches to prevent the Burlington Northern holding company.

REPRESENTATIVE SHONTZ: The Transportation Committee of Montana Legislature is currently in the process of hearing – holding a series of hearings; the first which was held in Glendive. The next hearing will be held October 26th at Kalispell, Montana. At this point we are receiving input from the citizens of the state to find out the direction that they want the Committee and the Legislature to go.

I think, the strategy that we must use is for the legislatures of the various states involved and, to the extent possible, the executive branches of those states involved to coordinate an effort in Congress to, perhaps, change the law to better benefit the people of our states.

COMMISSIONER CONRAD: Representative Shontz, there are four main questions that I raised at the beginning of this hearing. The first is: Will a holding company structure adversely affect a rail operation? What would your answer to that question be?

REPRESENTATIVE SHONTZ: Based on the experience of Montana in dealing with the Milwaukee railroad, I would have to say, absolutely, yes.

COMMISSIONER CONRAD: The second question I have asked is: Has the railroad paid for those land-grant assets that it has received? Have you had a chance to evaluate that question and formulate an answer?

REPRESENTATIVE SHONTZ: One of the concerns that I have is that I don't know if we really know the extent of the wealth of the holdings of the Burlington Northern to date. We are having – the State of Montana is currently in litigation to ascertain the listings of the property of the Burlington Northern in Montana in pursuit of the property tax case. And I think that until we can find out exactly what those holdings are, we would be premature in making that decision.

I am concerned, though, as I mentioned in my statement, that we are seeing a reflection or a movement of resources that were given to the railroad for the purpose of subsidizing its operation that are being removed from that subsidy. Of course, in my opinion, that, therefore, jeopardizes the service that the railroad is providing.

COMMISSIONER CONRAD: The third question that we raised is: Does the railroad intend to shift land-grant assets from the railroad? That will be addressed by others, I am sure, here today.

The fourth question is: Is BN in a position to be anticompetitive on coal? And, of course, given the fact that they are a monopoly carrier in your state in terms of rail transportation, that would seem to indicate that they may have the potential for anticompetitive behavior. What's your reaction to that?

REPRESENTATIVE SHONTZ: I think, at this point in time, the Burlington Northern railroad is, in the energy field, particularly in coal, definitely in a monopolistic situation. It's very — we're very hard pressed to ship coal out of eastern Montana unless it goes on BN tracks at some point or another. And one of the concerns that I think all of us in both Montana and North Dakota should share is — relates to our coal severance tax. We find, for example, that coal that is burned in the Twin Cities — Minneapolis-St. Paul — comes from Baker, Montana and, yet, 65 to 70 percent of the total cost of that coal delivered to the utility is transportation costs. I feel that our states, because our severance tax is, respectively, 30 and, I believe, seventeen and a half percent, are being accused of overtaxing or attempting to be Arabs to the consumers of Minnesota. I think the Burlington Northern is, perhaps, the perpetrator, not us.

COMMISSIONER CONRAD: Thank you very much, Representative Shontz, for your testimony and taking the time to come and appear. We appreciate that very much. We also look forward to close cooperation with you and your colleagues in Montana on this issue and others over the coming period of time. Thank you very much.

REPRESENTATIVE SHONTZ: I appreciate the invitation.

COMMISSIONER CONRAD: Next, we have scheduled Mr. John Creedy, who is President of the Water Transportation Association. Mr. Creedy, who is from New York City, New York, has been very active in pursuing the national coalition on the question of formation of a holding company. Mr. Creedy.

MR. CREEDY: Thank you very much, Commissioner, and ladies and gentlemen.

My name is John A. Creedy and I am President of the Water Transport Association of 60 East 42nd Street, New York City. Our association is a national trade association of water carriers operating on the inland rivers, Great Lakes and in the coastwise and intercoastal trades.

As you know, western coal and grain reaches significant markets in the nation and the world through rail-water connections at various river and Great Lakes terminals. Our members, thus, have a vital interest in the continued economic viability not only of the BN, but also of the other major rail systems making connections with water service on the rivers and the Great Lakes.

Truck-barge combinations also, of course, compete with the railroads and the resulting competitive interaction assures optimum efficiency of the rail mode, the truck mode, and the water mode. And this is of great significance to shippers. Part of the credit for such highly efficient rail services as the unit train for both grain and coal can be attributed to pressure on the railroads to respond to competitive water services.

As background for this discussion, let me say that the railroads have traditionally complained that this competitive pressure is unfair, alleging that there is an imbalance of subsidies between the rail and water modes.

Some three years ago, WTA undertook an industry assignment to determine with scholarly exactness whether there was any truth to the railroad allegation or whether the many subsidies to the railroads did not, in fact, more than balance the score and render inappropriate the railroad campaign in support of crippling waterway user charges.

These major studies of Federal aid to railroads have so far been published and are attached to my statement for this record. They include, "Financial Assistance to Railroad Retirement," "Government Capital Assistant Programs" and "Grants of Public Lands to Railroads."

The three studies document the fact that Federal aids to the different modes are of many types; maintenance of waterway rights-of-way, Federal aid to rail pension funds which lowers labor costs, a variety of capital assistance programs for railroads and current income from land grants, but all of them have a competitive effect.

We have not yet extended our studies to include such major items as special tax incentives and concessions to railroads, nor have we examined the value of seaport channel maintenance by the Corps of Engineers at such seaports as Norfolk, Virginia, mainly used by railroads, or a variety of other Federal aids of one sort or another.

Our three studies so far demonstrate, without much question, that there is far more in the way of Federal aids to railroads than to the competing barge mode.

We do not urge high taxes for railroads to recover the cost of these Federal aids. We do say that there is no logic to justify increased taxes on the waterways unless and until there is a comparable form of cost recovery for the railroad mode as well.

In the course of our researches into what's on the rail side in terms of subsidies, the water carriers commissioned the first new look at the land grants to railroads in some thirty years, perhaps the first comprehensive analysis of the conflict created by the railroads' handling of these government-granted riches in this century.

As a result, we have taken certain actions and are considering other actions to make sure that the land-grant wealth is applied to keep the land-grant railroads economically viable in performing their obligations.

We are not, at this time, challenging the right of the railroads to continue holding the government-provided lands, though many of the land-grant railroads appear to have broken their basic covenant with the government by transferring the land-grant resources out of the railroads to conglomerates and affiliates without proper or, indeed, any compensation to the railroads and may thus have forfeited their right to continue to hold the lands.

We are not stressing the frauds that have occurred in the disposal of these lands, though a couple of farmers in Arizona recently won a jury award of $21 million dollars on the basis of a fraud allegation against a land-grant railroad. And this may open up the whole question of the propriety of the behavior of the railroads.

We note in passing that an earlier Congressional attempt to obtain facts on the land grants was met by a Southern Pacific response that, in any such inquiry, the Southern Pacific would have to take the Fifth Amendment. We haven't yet asked what that is all about.

WTA has placed in an appropriate legal forum before the ICC in the merger of the UP-MP-WP the proposition that in any approval of the merger, the ICC require the UP holding company to reconvey the land-grant assets to the railroad and, in any event, count current income from lands and mineral rights provided by the government in its determinations of adequacy of revenues and earnings of the railroad.

If this were done for the UP and for the other land-grant railroads, it would have a dramatic effect in moderating rate increases and preventing abandonments on these vast rail systems for which the government has provided such valuable land grants for railroad purposes.

The water carrier interest, of course, is in moderating rates between western resources and the Mississippi River crossings and the Great Lakes, but if we are successful — and there is no doubt of the power of the ICC to take into account land-grant income in its rate decisions — such a development could have major consequences in stimulating the economies of all the western states.

The logic of it is irresistible. The government provides hydroelectric dams on the Columbia River and electricity rates in the Pacific Northwest are, by far, the lowest in the country because of the subsidy. Rates for city commuters are lower than they would otherwise be because they benefit from mass transit aid and so are rates of rural electric co-ops benefiting from government financing aids.

Why not land grants? Why not, indeed. The idea has been taken up by a number of powerful committee chairmen in Congress, John Dingell of Michigan, Chairman of the powerful Railroad Oversight Committee; and John Seiberling of Ohio, chairman of the Public Lands Subcommittee. On the Senate side, Max Baucus of Montana has had a number of useful exchanges with the ICC on the subject.

I would like to enter into the record at this time the ICC's comprehensive report, pursuant to a Congressional request, entitled "Railroad Conglomerates & Other Corporate Structures," February 5, 1977.

The ICC assumed a responsibility, by adopting this report, for monitoring the railroad handling of government-granted resources. The report particularly discussed the vulnerability of the Burlington Northern to the diversion of land-grant assets from the railroad to a corporate holding company.

Their concern was expressed as follows: "The national transportation system could be potentially affected by the holding company corporate structure through the denial to the railroad of already separated assets it acquired over the years by government grant, retained earnings, et cetera, which, in times of economic stress, dould help to maintain the carrier's plant at an adequate level, or to finance necessary activities which might otherwise be impossible. Also implicit is the fact that the denial of the earning power of these assets year-by-year has reduced the earning power of the railroads themselves. While not as yet measurably reducing the railroads' operational ability, this denial does reduce the railroads' attractiveness as an investment to creditors and the ability to cover fixed charge requirements on a possibly growing debt structure." Also, they might decide to sell the railroad all together.

The ICC summed up its concern: "We are particularly concerned that lands which were granted by the Federal Government to railroads to enable them to fund the construction and operation of their rail lines — or the proceeds from the transfer of these lands or of interests in those lands — have been and will be transferred from the railroads to their parent holding companies at less than fair value. Were the railroads receiving these properties, or their railroad successors in interest, to be deprived of the fruits of these land grants at a time, whether now or in the future, when they are needed to support rail services essential to the public interest, the intention of the Congress in making these grants would be subverted, and today's citizens would lose the benefit of the contract made by their forebearers with the land-grant railroads."

But the ICC at that time doubted that it had enough power to maintain adequate control of railroad abuses in the handling of the land-grant assets.

The Federal courts are another resource and the water carriers are considering litigation that will attempt to find an answer for the many unresolved legal questions involving the handling of the land grants by the railroads. In the meantime, we met in August in Fargo at the invitation of Kent Jones. And the water carriers are supporting those who are seeking a Congressional investigation which would, more or less along the line of the resolution passed, establish the value of and income from the government-provided lands and mineral rights currently held; determine conclusively the validity of the railroad claim that the land grants have been repaid by rate concessions taking into account a comparison of the value of the land and the value of the rate concessions on a comparable basis, the extent to which rate concessions which were counted for purposes of repayment were provided by nonland grant railroads, the extent to which railroads were compensated at the time for reduced rates on government traffic by higher rates on commercial traffic, the extent to which equity of the government required return of the lands still held to offset elimination of the land-grant rates; determine what authority the ICC should have to control abuses involving land-grant assets; examine the use of holding companies to avoid review of security transactions and to reduce apparent rail income; examine the extent to which abandonments in the west should be permitted on land-grant railroads.

We may well be at the watershed turning point in the realization of one of the most significant economic promotional ideas of the century for the west. We are all aware — not least in North Dakota and the northern tier states — that transportation, whether it is barge, rail, truck or pipeline, is fundamentally an agency of development. One of the very first laws passed by the Congress in the 18th Century was for the development of roads and canals.

Ours is a nation of great distances. It is remarkable that Powder River coal, by efficient rail service to Duluth and by steamship beyond, can be marketed seventeen hundred miles away in Detroit. It is remarkable that North Dakota wheat moves easily via rail and truck-barge to Portland and across Pacific and also by rail and truck-barge via New Orleans to Europe. We in the Water Carrier industry would like to help you maintain maximum efficiency in your transport services and we hope you will help us in making sure that national transport policies governing such subsidies as the land grants are applied as Congresses of the last century intended that they should be. The land-grant assets still held by the railroads have never been quantified, but we know they amount to many billions — hundreds of millions in income available for transport development every year.

The water carriers have taken the lead in researching, developing and calling attention to this vital issue of the proper application of the current income from land-grant subsidies. We welcome the interest of North Dakota in the development of an even-handed national transport policy to maintain essential rail, water and truck competition at peak efficiency. We appreciate this opportunity to appear before you and would be happy to answer any questions that you may have.

COMMISSIONER CONRAD; Mr. Creedy, one of the questions that we have before us, as we said before, is the effect of the holding company structure on the rail operation. And I'm wondering if you could sum up your opinion on the effect of the formation of a holding company structure on the rail operation; that is, specifically, will the formation of the holding company by Burlington Northern adversely affect or does it have the potential to adversely affect the rail operation?

MR. CREEDY: I think the ICC Conglomerate report answered that very distinctly when it said that they were most concerned about it, that it obviously can have a negative effect.

COMMISSIONER CONRAD: The second question that we have repeatedly asked is: Has the railroad paid for the assets is has received? From your testimony, I gather that you are calling for a recalculation of what assets have been provided the railroads and what are the amount of concessions that were granted. Is that a correct interpretation of what you said?

MR. CREEDY: That's correct. And in the study that was done by Jessie J. Friedman & Associates, which was published sometime in March, 1980, entitled "Federal Aid to Railroads, Grants of Public Lands to Railroads," there is a discussion of the railroad land-grant concessions. I would be happy to read those to you, if you like. It's in the record for you, but they are interesting. The calculations made at the time Congress agreed to cancel the rate concession understated the value of the granted land to the railroads in comparison to the value of the rate concessions made by the railroads. An investigation would show that the calculations should be made on a comparable basis using an interest rate to adjust values over the intervening years.

It fails to distinguish between the rate concessions which the railroads receiving land grants were required to provide on government traffic and the equalizing rate concessions made entirely and for profit reasons by the non-grant railroads, and so on. I think that's in the record. And you'll find that any fair and reasonable person would conclude that there has been no repayment.

COMMISSIONER CONRAD: As far as you are aware, in the study, was there any review of the question of whether or not there should be a return of land-grant assets?

MR. CREEDY: Well, the study from which you quoted, the Board of Investigation and Research, in 1944, in concluding – in saying – and the railroads frequently quote this statement – that the land-grants had been repaid – land-grants had been repaid by the rate concessions omits a vital paragraph. There is another paragraph which says that the railroads should at that point in 1946 return the remaining lands so that the government's concession would not be a one-way street, that there would be a concession from the railroads at the same time. That, as you know, didn't happen.

COMMISSIONER CONRAD: What you are talking about here is the study that was done to determine whether or not the concessions required of the railroads as a result of the Land Grant Act should continue or not. That's referred to as the "Board of Investigation and Research."

MR. CREEDY: That's correct.

COMMISSIONER CONRAD: And, specifically, I assume you're referring to the quote, "As a condition to the repeal of land-grant rates, it would not be unreasonable to require that the remaining Federal lands be restored to Government ownership, except for those which are used in carrier operations as right-of-way or for other purpoes."

MR. CREEDY: That's correct.

COMMISSIONER CONRAD: I assume that's –

MR. CREEDY: Yeah, but I think –

COMMISSIONER CONRAD: That never occurred, did it? There was no return?

MR. CREEDY: There was no return. And we had not – we have not, in our pleading before the ICC, urged that. We have urged that they be returned to the railroads, reconveyed to the railroads from the holding companies.

COMMISSIONER CONRAD: To your knowledge, have there been cases where railroads have formed holding companies and assets have been transferred away from the rail operation, resulting in a deterioration of service?

MR. CREEDY: I wouldn't want to testify to that, because the ICC found that, as I quoted, up to that time, 1977, there had been no impact on railroad operations. And I think that there have been occasions where the reverse was true, where land-grant income has been used to upgrade and rebuild railroads. It's the potential we are talking about. I think everybody agrees to that.

COMMISSIONER: Again, the report to which you refer, I assume, is the report entitled "Railroad Conglomerates & Other Corporate Structures"?

MR. CREEDY: That's correct.

COMMISSIONER CONRAD: The report to Congress as directed by Section 903 of the Railroad Revitalization and Regulatory Reform Act of 1976. You make an interesting point. I am quoting from that document that says, "While there is as yet no apparent causal relationship between railroad corporate structures and the fortunes of the carriers as functioning entities despite the loss of substantial earning assets, the continuation of asset separation poses a potential threat to the future health of the nation's rail system." What they are talking about is the future problem?

MR. CREEDY: We follow, for instance, the Burlington Northern. It's a connecting railroad of ours and we feel that it has done a magnificent job of renewal in the past five years. And I would like to see it continue.

COMMISSIOER CONRAD: Very good. Thank you, Mr. Creedy, for providing that testimony and expanding the record which we are hoping to establish here today so we can have a factual basis for our decision-makers, not only in the State of North Dakota but elsewhere as well.

Next we have Mr. Patrick Foley, who is an attorney, who is in litigation on behalf of the Burlington Northern Employees Union. Mr. Foley is here.

MR. PATRICK J. FOLEY: Commissioner, thank you very kindly for the invitation to appear today. I am an attorney. I am from Minneapolis. And I represent several labor unions which represent a large number of employees of the Burlington Northern. They are the Brotherhood of Railway and Airline Clerks, Consolidated System Board of Adjustment 46; the Brotherhood of Railway Carmen, Joint Protective Board; the Allied Services Division of the Railway and Airline Clerks; the Brotherhood of Railway Signalmen; the General Committee of Adjustment Union, United Transportation Union, No. 386; the Yardmasters of America, the Brotherhood of Locomotive Engineers of the BN and the International Brotherhood of Electrical Workers.

It's a real pleasure to appear. North Dakota has a great history of trying to represent the people and protecting their interests. It's kind of like the old Granger farm woman who said, "We ought to raise less corn and more hell." I think that's what it's going to take, because it's going to take – because we have got an awful problem. We labor people not only try to protect for wages and hours and working conditions, but the jobs themselves are very important. We want to do what we can under the theory of Rhett Butler from Gone with the Wind. He was an old bond dealer in railroad bonds; a bit of a heart, though. He said, "If you were run over by a train, your death wouldn't sanctify the railroad company." But we can ask today, you know, if the railroad runs over our jobs, that doesn't sanctify it.

We lawyers are not generally considered the most reliable people in the world. The Gallup Poll recently in the papers found us far below the clergymen, druggists and dentists, but we were above car salesmen and the railroad management didn't even make the scoreboard.

So while I might be humble, I don't show it very much when I am talking about railroad management. You know, then we ask, whom are you trying to protect here by protecting the old private enterprise theory of allowing management to make its decisions unfettered by the law, the public officials or labor unions. Well, there was an interesting article in the Chicago Tribune. I travel a lot in my union business and I pick up newspapers and Xerox excerpts. One of the good stockholders of the Burlington Northern, to the tune of nine million dollars in market value of their shares, is the oil-rich nation of Kuwait, you know. They also own a great deal – thirty-seven million dollars in the Union Pacific. We have got enormous salaries and fringe benefits paid to management. I am not against people making a profit. I think that to get a good president of a good railroad, I think to sell Mr. Bressler twenty-five thousand shares of stock was fair and reasonable. He should have a vested interest in his corporation. On the day that he received it a year ago, it had a market value of one million seventeen thousand dollars. Now, that's what the market value is. What he paid for it was two thousand five hundred dollars. Not a bad bale of hay.

The president – or the Chairman of the Board has a salary of $240,000, with additional fringes of $925,000. So whom are we trying to protect here.

I think what we ought to do is go back to the land and stay with it. And when you start separating the Burlington Northern railroad company from all of the assets that have given rise to this enormous corporation, you're going to have a fantastic collapse. I am going to develop some of my theories along that line.

This area, you know, is claimed and controlled by many nations; the Chippewa, the Sioux and the French and the English and, of course, the United States. It was part of the Louisiana Purchase, which is one of the greatest land transactions of all times; that we got this whole area for fifteen million dollars in 1803. Unions of course, have not had that free enterprise spirit going back with the protection of the laws to the extent that the railroads and other management have. We really weren't even legalized in this country until the Railway Labor Act in the 1920's, then in the Wagner Act.

Generally speaking, they were – unions became legalized. Until then, going back centuries, with the protection of the English Common Law, which I recall, we always objected to, we were criminal conspiracies, not only in England, but in this country itself.

A friend of mine wrote an unpublished book. It says, "From the beginning of ancient times, the land upon which we stand has fed the buffalo. This is what the red man has called home for thousands of years. Now all this will change. The land belongs to the railroad and to the Government. This is progress." I am not so sure it is.

The railroad transportation system, you know, is not just a product of imagination, self-sacrifice and hard work. They were given enormous acreage. It's been variously estimated from one hundred fifty million acres to one hundred seventy-five million acres of land in this country. Twenty-four percent of the State of North Dakota, twenty-four percent of Minnesota was given to the railroads — corporations to build the railroads. The Intercontinental Railroad was first completed well before Jim Hill got into the railroad business. He was operating the Selkirk freight steamer up the Red River, up to Winnipeg, and invoked a Federal law that resulted in giving him, in effect, monopolistic control. He paid for the cost of his whole steamboat on his first voyage. Somebody up here in North Dakota — I don't recall who it was — said, "After the grosshoppers, we got Jim Hill." And I think there is a little bit of truth to that.

He got into the railroad business in 1878, the year before my grandfather came from Ireland and became a section hand. But they started in the railroad industry at different levels. Jim Hill bought this railroad at half price on foreclosure. The next step that he did, of course, was to run the competing Northern Pacific into bankruptcy in the 1890's; then, with J. Pierpont Morgan, worked to combine the two and the CB & Q — to give them control from Seattle down to Chicago. It used to be quoted that the Great Northern was not a land-grant railroad.

Well, actually, what happened is they got 65,000 acres of land up along the Red River, but they really didn't do much with it. And they didn't build a railroad up there, so in the 1890's, the farmers up along that — well, people came in and became farmers and they tilled the soil and plowed the acreage and made it into a very fruitful, rich agricultural area. And then Hill wanted it back. They had not done anything with the railroad to warrant the land grant, but there was a big brouhaha. And, then, you got the politicians involved, not all quite so idealistic and competent as Commissioner Conrad.

In those days, things worked a little bit differently; at least not the way Commissioner Conrad operates. Congress then passed a law and gave them other land in lieu. They have exploited that on the Great Northern the same way that the other Burlington Northern predecessors exploited it — the Northern Pacific. It had several collapses. It got the original land grants and the Federal statutes of 1864, when it was chartered as a federal charted corporation. You know of the old story, everything is bigger and better and we have got to improve and expand and develop our railroads. Well, in 1894, fifty percent of the railroad mileage in the United States was in receivership. That included the Northern Pacific, the Reading, Sante Fe and 149 other railroads that collapsed with our capitalization at 2.5 billion dollars in those days. The first person ever to be prosecuted for Federal antitrust criminal violations was Eugene Debs, President of the American Railraod Union. He was kind of an aggressive guy. He called out some people on strike on the Great Northern. And Jim Hill called him in and said, "You can't do that, you don't even represent those guys." He said, "If I don't represent them, why don't you send them back to work?" So they kept them out for about sixteen or eighteen weeks. They finally got some concessions. That was still when we were considered, technically, a criminal conspiracy in this country. Northern Pacific railroad company went bankrupt for the umpteenth time in the 1890's. Then, the Northern Pacific railroad, now the railway company, bought it from the former. To finance that, the new company had to mortgage all of the property to satisfy all of the judgments throughout the courts, to get out of the receivership and the bankruptcy. And they did that.

And I have brought suit, on behalf of my various railroad unions, representing many of the BN employees, on the grounds that those mortgages entered into in 1893 or -4, I think, required a lien for the two trustees of all of the railroad land, all of its property and assets of every which kind; personal, real and mixed, as we lawyers would say. Well, the courts have been slow on the grounds that this really belongs in the ICC. The ICC says, We don't have jurisdiction. And, of course, the Burlington Northern says, Who, me? So it's a situation of being tinkers to evers — to chance; although, everybody is dropping the ball and nobody will take control yet.

In the 1890's, Hill and Morgan created one of those major stock coups and everybody who sold their stock at high prices on the theory that it would be a crash and then every stock would be sold cheap. Of course, Hill and Morgan kept the stock, so there was no fall. As for an explanation, why, Morgan said, "I owe the public nothing." Hill was the one in the 1890's that developed the theory of the holding company. Morgan said that Hill won't live forever, Morgan won't live forever, which I thought was a rather condescending approach to their own mortality, but Hill's statement was that if they put it into a holding company, unless they do that, they would also be subject to attacks like the recent one to secure control of one or the other of our properties.

Now, the Water Transport representative quoted from the Friedman & Associates study, a copy of that which was given to me by Jerry Alper. I think you know him. He is one of your counsel in Washington, a very outstanding lawyer. And that study points out that 223 million acres of state and federal lands have been granted to the railroads. I think you — they think they are going to get something for them, but the land-grant railroads constructed only eight percent of all of the railroad land — railroad mileage in this country for 223 million acres. I am trying to abridge this or I'll keep you here all day.

It's on the theory of the old speech, it's like a love affair. It's easier to start than stop. The Friedman study — and he studied it to the extent that he could — this business of the land-grant restrictions. Nobody has ever found except the railroads — and they don't tell us where the restrictions of the 1864 statutes were eliminated. And those restrictions are that "Thou shalt keep thy property in land grants for the railroad operation;" obviously, a paraphrase.

The merger of the Great Northern and the Burlington Northern in 1970 ended one era where I had been a section hand on the railroad and struggled through law school. Then I started suing them and we have become rather close acquaintances. Since that merger, March 3, 1970, I was in court within a week. My first, the Interstate Commerce litigation. I don't think since that date I have been entirely out of court with the Burlington Northern on labor and interstate commerce transactions. You win a couple, you lose a couple, but we're there. And I guess it's like the old Irish theory, it's better to be quarrelsome than lonesome. I don't like what they are doing. They merged into the Burlington Northern from the CB & Q, the Northern Pacific and the Great Northern. But they merged and it was argued that the rich land holdings of the Northern Pacific should be separated. In fact, there was a separate claim before the ICC to eliminate the land resources, put those into a separate corporation for the stockholders of the old NP. Well, the NP president, Macfarlane, said that those transportation properties were an important source of income to the company, that such a spin-off free of our prior lien and general lien mortgages, to which they are subject, would be opposed by the trustees of the mortgages, would involve us in litigation and probably could not be successfully consummated; and that to have a spin-off of the mortgages would — is not practical or desirable because of tax consequences and other reasons. It was accordingly concluded that Northern Pacific's rail and nonrail properties would have to be included as a package in any deal made, if one were to be made. And we sued around for another ten years. Then we have another merger when the Burlington Northern and the San Francisco Railway Company — St. Louis-San Francisco Railway Company were merged in 1980. Now, I don't know whether it's great to have free enterprise. Here's what they have done. Instead of helping the Milwaukee road out of its own stupid management or the Rock Island, two that are really in bad shape, that need financial help, they take two profitable, efficient, relatively competent organizations. Certainly, they are smart. I put relatively competent in there in the sense that I am not sure that they are really going to protect the railroad. They take good railroads and merge them and let the ones that are really struggling go down the drain.

Well, the Commission held in 1980 that the financial strength of the BN is due in large measure to the existence and development of its nonrail assets. Those are the ones they are going to split. The Commission — I don't know. You know, they are like bureaucrats, they know what they are doing. Some of these politicians that are hold jobs for a little while to get a better one, it's a little hard to figure out what they are going to do. I don't think they read the Commission order, except the bottom line where it says, Okay, go ahead.

What the Commission report contained, whether — whoever wrote it is hard to tell — is, among other things, "Those in a position to control a railroad's actions can divert the carrier's income, property and other assets for nonrail purposes. This opportunity exists to a significant degree when the parent holding company controls the railroad. BN will not be in a position to form a holding company for many years due to bond indenture restrictions. Therefore, the opportunity for a diversion of assets to other sources does not presently exist." Yeah, uh-huh, exactly. That's what they said.

Well, then, a couple months later, they got a new president in and times change. Well, I sue the Burlington Northern. I file a prolific statement to the ICC and I outline the mortgages of 1896 — or 1893. I have pointed out what the Commission apparently said and argue that when they are proceeding on a merger on the assumption by everyone that they can't and, therefore, they won't have a holding company, which gives rise to many potential problems and then they do it on their own without ICC approval, it's depriving us union people of an administrative hearing, where we can argue the pros and the cons and maybe attach conditions. Well, they said they didn't hold that and they have no jurisdiction and they have got that in the court of appeals also. Now, depending upon which document and at what time, the Burlington Northern owns a lot of railroads. In their own statement, they have said. If you are clever, you can exert substantial control if you own ten percent of the stock. Well, they own many railroads, many nonrailroads and the physical property in a few more. You know, it's a funny thing. The statutes provide that any company is subject to the ICC jurisdiction if it controls two or more carriers. Now, you know, how the Commission gets around that — the Commission says, Well, that doesn't apply, if those two or more carriers are operated as an integrated or unified railroad. Now, the statute does not say that. The Commission said it.

So I have charged in my documents that the Commission is running with the hares and riding with the hounds. And they have done it this way.

Now, Mr. Water Transport over there, Mr. Creedy, brought up that 1977 report on conglomerates. Here's what the commission is doing in convincing the courts, "Look, we're doing this thing with the Congressional approval because they have never reversed our decisions." So the Court says, "We really shouldn't pass laws around here." All right. Then they go to the Congress and they say, You know, based on this study, the Commission has got this authority. We don't need any more laws. And they – they have got one in 1969 called the conglomerate merger. And the Bureau of Accounts of the ICC writes, Therefore, it is strongly recommended that the Commission take another look at its position that in the acquisition of a railroad system a holding company is not construed to be a carrier under the terms of the act. It is obvious that the rail companies could become involved in a precarious financial condition as a result of unsound security issues by the conglomerate parent. If this should occur, the primary source of income or assets would appear to be the carrier component of the holding company. The potential risks to the future of rail service seem great enough to warrant the extension of ICC control of the holding company. So they got sixes and sevens here, they got the courts and the Congress believing they are doing the right thing.

Well, they want to get out of the holding company. They are out of the railroad system, so that all of their assets are not controlled by the Interstate Commerce Act which restricts the corporation investments to be consistent with railroad operation. Well, they don't even get the right information to the Commission and the Commission doesn't want new detailed information.

Let me give you a couple of for instances. And I know that my time, like everything else, is running short. They have got listed on their financial documents fifty-eight million dollars in BNAFI which is an air freight forwarder. You know, it's a freight forwarding by air. It's worth one hundred fifty million dollars. I don't know why the Commission doesn't get up to date and say, Let's have current values. But, at any rate, here's what they can do with that. They can take that one hundred fifty million dollars owned by the railroad, declare it as a dividend to the holding company tax free, no obligations on it, the holding company can put it over here to another corporation and they got themselves a nice little package scot-free worth one hundred fifty million dollars. The railroad gets nothing for it and the newly held corporation, which I call a cousin to the railroad, doesn't pay a dime. All right. They have got in their annual statements coal and minerals of enormous value, 3.7 million. That's not in this state. Well, their own financial – or one of their own financial researches was done by Morgan Stanley of New York, a financial consultant corporation which cannot be identified in the normal context with Arthur Townley. I mean, the two just don't swing by the same vernacular. But in the Morgan Stanley study, they have a quotation of an old saying, "All wealth emanates from the land." And the Morgan Stanley study of last November points out that the oil and gas which was listed in the 1980 BN report at seventy million dollars is worth two hundred twelve million dollars. The coal and mineral listed at 3.7 million is appraised by Morgan Stanley at 1.4 billion dollars. Well, without any fiscal legerdemain, I have concluded that coal that they say is worth 3.7 million is probably worth 14.7 billion. Not too bad. That's on the basis of the new President's estimate that they should quit getting the small percentage, like six cents per ton, on their coal and sell it for a dollar a ton. 14.7 billion tons of coal times a dollar equals a couple billion dollars. As old Everett Dirksen said, if you keep talking about fourteen, sixteen billion dollars, pretty soon you'll be talking about real money. That's – what we have got here is nobody is in charge. That's why I really think that Commissioner Conrad has to be complimented because he is trying to bring whatever publicity may do to affect, perhaps, the Commission, which I think is, maybe, reaching rather hard. Perhaps Congress.

You know, I referred to A.C. Townley. He was a great guy from the Non-Partisan League. Whether you like him or dislike him, whether you approved of some of the things he did or not, I think you can all agree what he said at the end of one of his speeches, "If you put a lawyer, a banker and an industrialist in a barrel and rolled it down a hill, you'll have a son of a bitch on top all the way."

Thank you very much. (Applause)

COMMISSIONER CONRAD: I believe we have had a number of questions that have come up, what I would call auxiliary questions. One of them is whether or not there has been any transfer of assets from the rail operation, specifically land-grant assets from the rail operation, to the profit centers in the holding company.

MR. FOLEY: You mean, in the Burlington Northern or in other –

COMMISSIONER CONRAD: In the Burlington Northern case.

MR. FOLEY: I don't know yet. We all know that they are going to. They have got some restrictions. And, of course, the major asset is their coal, 14.7 billion tons. And there is some other minerals as well, as you know. Well, they are presently barred from carrying their own coal on their own property for resale to the public. They are also barred from leases – getting federal leases for coal mining from the Federal Government. Obviously, they are going to transfer these assets. I plan to find out what they are, but I am sure that management can tell us, because there is no point in going through all of the torturous efforts that they have experienced and undergone and keep the assets of the railroad.

You see, what they want to do is they want to relieve, Commissioner, the assets from the restrictions that they have to be available and consistent with the railroad purposes. I tried to meet with the president of the railroad and he was in Japan on a coal transaction. Well, railroads don't run there yet from here. He, of course, is a petroleum industry representative, at least in his background, from ARCO. I see in their new 1981 October report to their employees that ARCO and the BN are going to invest in – just a little million dollars into a study for a resource facility in the State of Washington; apparently, for ocean-going vessels. I think ARCO is also interested in the coal slurry, but I haven't tied anything directly.

I am sure that BNAFI, their air freight forwarder, which is a capital-intensive project and very disastrous for railroads – I am sure that is going to be available eventually. They may want to wait until some litigation and Congress kind of takes their way. For instances, they asked and answered the question in the October Burlington Northern News about – are they trying to get out of the railroad business? They say, no way, maintenance work will continue. Well, if it doesn't get any better, we're in trouble because, according to the Frisco merger order, the BN reported 783 accidents for 1976, second only to ConRail. ConRail, for those of us interested in ancient history, you may recall, came from the Penn Central. Penn Central, you know – I was observing two guys at the stock exchange one day. One guy says, "You know, it's too bad, you know, I don't know how to tell you this, I got VD at 79." The other guy says, "Don't feel bad, I got Penn Central at 110." What they did with the Penn Central may be prophetic here. What they did is, here is the marvelous railroad, the New York Central. The other one is the Pennsylvania Railroad. They merge into a phenomenal thing called the Penn Central. They ran out of cash. They couldn't pay the cotton pickin bills and they got a billion dollars worth of real estate in downtown Manhattan.

I tell you this much, any damn fool who kept on with Penn Central stock when it went to hell, kept onto it, they got rid of the railroad – that's a marvelous stock today, I'll tell you. It's a great stock. It can be the same thing here. Other railroads have traditionally transferred assets. I don't know why they would. They want six profit centers, they wanted five. Let's put this one off. That's what the ICC did. The other, Northern Central, that's a tortuous twist. I have even got a separate little chapter on that. That involves a lot of time.

Yeah, we don't know what the BN is going to do, except that we know they are going to do it. Thank you very kindly.

COMMISSIONER CONRAD: Thank you, Mr. Foley. We're going to take a break now for ten minutes. Then we will resume with Mr. Steve Strege, Executive Vice President of the North Dakota Grain Dealers Association. And he will be followed by representatives of Burlington Northern, so ten minutes of break time so the person developing the record here has a break. Then we will resume.

(Recessed at 2:50 p.m. until 3:00 p.m., the same day.)

COMMISSIONER CONRAD: I will give everybody a couple of seconds to find their seats. We will now hear from Mr. Steve Strege, Executive Vice President of the North Dakota Grain Dealers Association. Mr. Strege.

MR. STEVEN STREGE: Thank you, Commissioner Conrad. For those of you who have enjoyed the stretch, I can assure you that what I have here is not the testimony that I am going to read, so bear with me.

Good afternoon to our Commissioner and ladies and gentlemen. My name is Steve Strege. I serve as Executive Vice President of the North Dakota Grain Dealers Association. We are a nonprofit, nonpolitical, voluntary membership trade association which represents the interests of the 600 licensed and bonded country elevators of our state.

First of all, I would like to thank Commissioner Conrad for calling attention to this matter and conducting this hearing. It is surely in the interest of all North Dakotans to explore the effects of the business reorganization of one of our largest corporate citizens. The announcement of this hearing stated there would be a focus on the ramifications of forming a holding company and the effects that decision might have on rail line abandonment. We do not claim to be legal or financial experts on holding companies. Yet, there is a grave concern among our membership as to what message the Burlington Northern is trying to send us in taking this action.

As we understand it, the formation of an umbrella holding company with its various subsidiaries will split off some very valuable and profitable assets from the rail sector. This is not an encouraging sign to the shippers and farmers who use and pay dearly for BN rail service.

Train service, branch line maintenance and repair have all been deteriorating over the past ten or twenty years. Section crews have been reduced to the level of merely janitorial service, if that. At times car supply has been woefully inadequate. All this happens while North Dakota shippers pay their freight bills at revenue to variable cost ratios two or three times those of other commodities. My question is: Can we hope for anything better if the BN is allowed to take its choicest holdings and run off with them to somewhere else?

Branch line abandonment is the issue of the day in North Dakota. These same highly profitable rates which I referred to a minute ago and milked repeatedly from the North Dakota shipper now mean nothing as BN attempts to redesign the marketing system of our region. BN claims lack of capital for rehabilitation of lines. Where then have all the revenues gone over the years? We suspect they've been plowed back into other business ventures which may now be amputated from the railroad sector. This transfer can only have the affect of further restricting both investment and operating capital for the BN. Branch line abandonment will then shift into an even higher gear.

BN says that their branch line abandonment plans are good for North Dakotans. If that is the case, then why have over thirteen thousand citizens of our state signed petitions during the last three weeks protesting rail abandonment? I have these petitions here. We are still accumulating them. These have come in so far. They come from virtually every town in North Dakota. They represent both BN branch line stations, they represent Soo line stations, BN main line stations, people on the Milwaukee. Most of the signatures are those of farmers. There are some storekeepers, doctors, ministers, whatever, housewives, who have also singed these petitions, so I think that there is a message that there are a great many North Dakotans upset with the branch line abandonment plans of the Burlington Northern.

Now, I know that BN people are going to stand here and assure us that all is well, that their executive officers have the welfare of their customers at heart, that rail rates will be held at a reasonable level when, in fact, the record shows otherwise, and that formation of a holding company will not lead to a decline fo the railroad sector. I also know former Milwaukee road shippers who recall those same assurances. We all know what happened to that company.

Land grants and mineral rights were given to the railroad for good reason. Development proceeded through the laying of track, the building of small towns and settlement of the prairies. Now, we are asked to believe that regression in the other direction is progress.

We think not. We think it is time to tell the BN that "No, you will not be allowed to eat the public pie and simply return the plate empty."

Thank you.

COMMISSIONER CONRAD: Thank you, Mr. Strege. I understand that your group is engaged in an effort and an advertising campaign to heighten public awareness on the question of branch line abandonments. And I was wondering if you would just briefly share with us the views of your membership on the effects of branch line abandonment in the State of North Dakota.

MR. STREGE: Well, yes, you're correct, our group has taken the stand in opposition to the abandonment plans of BN and, also, to counter the effect of their advertising campaign which we consider to be a lot of misinformation. This response that we have had has been very good. We have heard from — as I said, the petitions show — farmers, the businessmen, just about anybody from every walk of life in North Dakota seems to be concerned about rail abandonment. And like I said before, I think it should give our railroad a message, not a contrary message. I think that they should take it to heart that we in North Dakota believe their services are valuable and that we want to keep them. We don't want to see them leave us. We feel that they need us as well as we need them.

COMMISSIONER CONRAD: What are the direct concerns of the people that you represent in terms of the effect on the North Dakota economy of branch line abandonment? Would you share that with us?

MR. STREGE: We feel that small towns are going to be drastically affected, elevators are going to have to close up. This is going to force increased trucking of grain, which will be more costly, not only for the shipper, but also for the taxpayers of North Dakota in increased road maintenance and the like. As an elevator closes in a small town, farmers may have reason to go elsewhere for their other business, hardware business, grocery shopping. Some of that — that's been done already, granted, but — but this is just going to hasten the process. Local taxing authorities will be affected because of branch line abandonment and business closings. And, eventually, I think we're going to lose a lot of small towns in North Dakota, small towns that were built because railroads extended themselves out into these areas and made that progress back a hundred years ago or eighty years ago, whatever it might be.

COMMISSIONER CONRAD: What you are talking about is a very significant tax effect from this kind of development, as well as a serious economic effect to the small towns, farmers, other shippers, elevator operators in terms of the effect of branch line abandonment.

MR. STREGE: It will be both an economic change and social change.

COMMISSIONER CONRAD: Steve, I am just wondering if you could read for the record what the petition says that these thirteen thousand North Dakotans have signed.

MR. STREGE: The headline across the top, "Protest rail abandonment." It says, "As a resident of North Dakota, I hereby register a protest to Burlington Northern railroad concerning the proposed abandonment of our branch line railroads. We feel branch line abandonment will severly hamper the economic growth and future of our rural communities."

COMMISSIONER CONRAD: Steve, how do you deal with the assertion that we frequently hear on the part of the railroad that, Look, we have paid for everything we've gotten and, therefore, it's ours and we can do with it what we will? Do you have some reaction to that?

MR. STREGE: Well, as I state in my testimony, I don't think the BN should be allowed to eat the public pie and return the plate empty. The land-grant mineral rights issue is one of, I believe, continued service to these communities.

COMMISSIONER CONRAD: All right. Thank you very much for your testimony. We appreciate that.

Next we will hear from Mr. Kaufman, Vice President of Public Affairs of Burlintgon Northern railroad, and Mr. Allan Boyce, Assistant Vice President of Public Affairs for Burlington Northern, Incorporated, the holding company.

MR. KAUFMAN: Thank you, Commissioner. It's a pleasure to be here, I think, to be given the opportunity to discuss the Burlintgon Northern's activities and plans as they affect North Dakota.

We're going to have one short prepared statement delivered by Mr. Boyce.

MR. ALLAN BOYCE: Thank you. When Commissioner Conrad first invited us to appear at this hearing, he asked that we talk about the responsibilities that we have had as a result of the original Northern Pacific land grants, talk a little bit about the formation of our holding company, what it means to the State of North Dakota and, also, to talk about our branch line program. I am going to respond to each of those. And I really do appreciate the chance that we're getting to explain to you what we're doing.

Unfortunately, the term "land grant" that you have heard so much about isn't a descriptive one. It doesn't describe what the Congress did back in 1864. I suppose it's a permanent part of the language that we'll never get rid of. What the Congress really did was propose a contractual arrangement to the railroads. It said, We will make available a certain amount of public land if you will use that land to raise capital to build a railroad and if you will then carry government freight at reduced rates. The railroad companies, the ones that took advantage of this offer, did excatly that. They entered into a contract for something that might be called a construction loan. They sold some of the land to raise cash and they mortgaged the rest of it to sell bonds to raise cash to build a railroad into what was then an unsettled area.

The Government made this arrangement because there was no other way to get the capital to build the rail lines. The purpose of the land was precisely to provide that capital for building the railroad, not to provide a continuing operating subsidy. And you can research that through all the Congressional hearing records at that time. You can go through various Supreme Court decisions. It's all very clear. But this requirement that the railroad carry Government freight at reduced rates produced exactly the opposite result that some people are claiming the purpose of this land was to subsidize. What it meant was that it was a drain on railroad operations for many years until – in the 1940's, that requirement to offer reduced rates for all Government traffic was reduced. At that time the railroads have repaid many times the original value of the land.

Other forms of transportation, of course, were treated very differently. There has never been an attempt to charge highway users for the land that was provided for highway transportation, nor have the historical costs involved in building the inland waterway system ever been recovered.

You will hear some people say – you have heard some people say today that the railroads really didn't pay for that land because, today, it's worth a lot more than it was when it was originally granted back in the 1870's. I am not going to deny to you that in the last one hundred years it has increased. Of course, it has to follow – that line of reasoning would suggest that every one of us who owns a home or a farm ought to go back to the person from whom we purchased it from and pay them more money because, today, it's worth more than it was when we originally bought it. I don't think that makes much sense. I don't think anyone will volunteer to do this.

At the time the transaction was made, the contract was understood very clearly on both sides and payment was made. Frankly, I think we waste far too much time talking about the last hundred years of history. I think we ought to talk about the present, what North Dakota needs, what Burlington Northern is planning to do. The holding company is something that has been talked about a great deal today. I gather it's the subject of concern to many people. I want to tell you exactly why we formed a holding company and what our plans are. There are two basic reasons. We wanted to give all of our businesses a chance to develop to their fullest potential. That includes the railroad. In order to do that, we felt that the management of each of our companies, including the railroad, needed to devote their full attention to their own business. The natural resources that we own, timberland, the coal, the oil and gas, and so forth, has always been managed separately from the railroad as a separate division, separate people that are involved, but the lack of a clearly defined corporate structure for each of those businesses, the lack of full staff capabilities to back them up, legal, accounting help, and so forth, meant that many of our managers were not spending full-time on the area that they knew best. It also meant that some of those other businesses had to call on the railroad for legal, accounting, clerical help, and so forth. Now, those are separate. They each provide their own and each stand on their own.

Secondly, the formation of a holding company allows Burlington Northern access to the capital markets to support the growth of all our operations. As a railroad – this may not be generally known as a railroad, we were prohibited by law from issuing securities, stocks or bonds for any purpose other than transportation. This meant that as Burlington Northern railroad – prior to May of this year, if we wanted to develop our other assets more fully, explore for more oil or acquire timber companies or go into the air freight business, or whatever, any cash necessary to do that had to come from within the company. Of course, most of that cash was generated by the railroad itself. Prior to the holding company, there was absolutely nothing to keep us from taking cash generated by the railroad and using it to spend on other businesses. That was the only way you could do it, because you were prohibited by law from raising money to buy a lumber mill.

Now, we no longer have that restriction as a holding company. We don't have to depend on the railroad as a source of cash to expand these other businesses because we are permitted to raise money if we choose to invest in the other businesses. We are also, of course, still permitted to raise money to invest in the railroad. Far from threatening to divert funds from railroad operations, the formation of a holding company allows us to raise money independently of the railroad for development of our other properties.

A lot of people – some of them you heard today – have expressed the fear that the formation of a holding company will mean a downgrading in the importance and financial rating of Burlington Northern. Nothing could be further from the truth. Last year the railroad provided 54 percent of the pretax income of the Burlington Northern corporation. That's the highest percentage of pretax income earned by the railroad as a part of the company as a whole since it was formed in 1970. We're not about to let that big of a part of our business become weakened in any way. If we really didn't want to be in the railroad business and were on our way out, why would we have bought the Frisco Railroad last year, why do we continue to pour hundreds of millions of dollars each year, including this year, into the railroad business? The whole purpose in further developing all parts of our business is to have a financially stronger company. And as the entire company becomes stronger, the railroad naturally benefits by being a part of that family.

You have heard a lot of references today to a report prepared by the Interstate Commerce Commission back in 1977 which dealt with the subject of railroad holding companies. And I don't know if there is anybody else in this room like me. But I am one of those people who believes that not a hundred percent of all wisdom resides in Washington, D.C. But if you want to deal with that report, I think it's very interesting that the excerpt that you were provided with stops at page 72. It eliminates the section of that report called "ultimate conclusions and recommendations," which begins on page 73 and runs through page 75. If you had been provided with that in addition, you could read the first sentence on page 73, which says – this is the ICC talking – "Our review of the facts developed in the course of studies and investigations underlying this report reveals no direct causal relationship between any particular type of corporate structure in the railroad industry and the pricing of effective transportation service."

Again, I don't think the ICC knows everything, but if people want to quote from that study, we can quote from it too.

Railroading is a very cyclical business. We don't create a demand for transportation. We can't force people to ship anything. We are responding to the transportation needs of the industries that we serve. As such, we're subject to the changing world of grain prices, we are subject to the ups and downs of housing construction, the changing fortunes of the automobile industry, all of these things. If our railroad were not part of a corporate family that included members with more steady sources of income, we would not be nearly as strong as we are today. I gather, all of you are interested in a strong Burlington Northern serving North Dakota.

Finally, I would like to talk just briefly about our branch line program. I want to begin by saying that there is absolutely no connection between the formation of a holding company and our intention to close some of our branch lines. Decisions to end losing operations are made by all businesses regardless of their form of corporate organization. If a local elevator is in several businesses – let's say they handle a few implements, some fertilizer, some seed; one of those isn't paying its way, one is losing money, regardless of what their organization is, why would they voluntarily choose to continue a portion of their business that is losing money. There is no connection between a form of the corporation and a decision to take part of it that's dragging the rest of it down, nor is there any relationship between Burlington Northern's overall level of profitability and our desire to end service on those portions of our system which can no longer pay for themselves. Our branch line program and our new unit grain train operations are a response to changes which have been occurring for a long time in the grain marketing system. They are also part of a strategy to haul more grain by rail, not less. We fully intend, by providing faster turnaround time in our equipment, to simultaneously get a bigger share of the grain which is moved and also to have a higher capacity for hauling grain, because our cars will move faster in the unit trains. I think, while we may disagree about details, I think those are probably objectives that most of you would not argue with.

As you all know, the tremendous growth in grain exports which occurred in the 1970's has permanently and dramatically changed the market for North Dakota products for the better. The export market wants and, in fact, needs unit grain train operations to sustain the kind of growth which is taking place, to fill the huge ships that are calling at the West Coast ports. If Burlington Northern chose to build some kind of imaginary wall around North Dakota, pretend that the whole rest of the world's grain merchandising systems were not changing, we could do that. We could say, Let's keep going with our 19th century branch system one car at a time. We would not be competitive. You would not be competitive and we would both suffer. North Dakota and Montana are the last wheat-producing areas in the United States to get a unit train service. I am not bragging about the fact they are the last, but that's a fact. We are following a nation-wide, world-wide trend in changing. We are doing it because we want the transportation business. We want it because we think it will make this area competitive. I am sure you are all familiar with a map we published last June which shows 425 miles of branch lines which we intend to file abandonment applications on in the next three years. That is twelve percent of our system in North Dakota. Last year, it handled eight percent of the grain that we originated. The opposite of that is, of course, is also that that is saying, in the next three years, we have no plans to abandon 88 percent of our trackage. Some people have called this drastic. We think it's important and a needed response.

The map also shows another 783 miles of line which are under a study. When we say, under study, we mean that we don't know what the future of those lines are. This map represents our best judgment at this time as to what the marketplace will do in terms of changing the way grain is marketed in North Dakota. We have asked for input, we have asked for reaction. And believe me, we have gotten reaction on that. And we are already considering some changes and will continue to look at more changes in the map as we see the system evolving.

We could have chosen to put just a few lines on the map here and there and we could have waited until each individual line was almost out of business, till it had very little traffic left, before announcing our intentions. We rejected that approach. We think it's far better to share with the public our thinking as to how we see the rail system changing. If we're wrong about specific lines, we're willing to take a second look. I am sure we would have gotten a lot less adverse publicity, probably wouldn't even have this meeting called today if we had decided to have a sort of closed approach, just gradually, one by one, seek abandonment of the line that no longer has any business on it. We felt that it was our responsibility, in the interest of our future and yours, to share with you the thinking of how we see this system going. If we're wrong, we will change it.

There is a lot more I could say, but at this point I would rather stop and see what's on your mind and respond to any questions you might have.

COMMISSIONER CONRAD: Thank you very much, Mr. Boyce, for your testimony. First, I note with some interest that in your reading – from the ultimate conclusions and recommendations of the ICC report that you stopped at the end of the first sentence. And I will just go on to read the following sentences which I think may give a little bit different flavor to the conclusion that might be drawn. The report goes on to read, in its ultimate conclusions and recommendations section on page 73, "The ability of a railroad to perform needed services, and thus to continue to play its role in the overall national transportation picture can, however, be affected by the particular corporate structure within which it is situated if that structure provides the opportunity for those in a position to control the railroad's actions to make use of its income, property, and other assets for nonrail purposes. This opportunity has been found to exist to a significant degree only within those corporate structures in which there is a parent holding company."

It goes on to say, "The history of conglomerates in the railroad industry demonstrates that a parent company has ample power to strip its subsidiary railroad of valuable assets, to the actual or potential detriment of the carrier and of its ability to carry out its common carrier responsibilities."

Now, one question which came up the other day in the public meeting that was held by the Public Service Commission was the question as to whether or not there is the intention or, in fact, if there has been any transfer of assets under the holding company away from the railroad company. In response to a question that I asked on that specific question, Mr. Mcleod replied that there was not any transfer of assets away from the rail operation. I didn't pursue it too vigorously at that time, because I know that that's outside of Mr. Mcleod's responsibility, but I am interested in finding out if there has been any transfer of assets or if there is any intention of transferring any assets.

MR. BOYCE: First of all, I got some more quotes. I could – I would like to call a truce on the quotes out of the study. You know, I think a lot of people – I will answer your question first about the transfer of assets. The legal transfer of assets from the railroad company to the holding company has not taken place. I want to finish that sentence by saying, it doesn't matter. Before the holding company was formed, there was absolutely no prohibition from developing those assets by Burlington Northern. There was no requirement that we take the railroad – the money from the railroad and put it in one pot and the money from the coal land and put it in another pot and the money from the timber and put it in another pot and keep those separate. There is no difference.

I think everyone is placing a lot more emphasis on the corporate structure than they ought to. The only thing that a hoidling company changes is that, now, if we want to invest in those other businesses, we don't have to rely on cash generated by the railroad because we can go out and borrow money. It gives us access to additional capital markets. Whether or not those assets are ever legally transferred to the holding company or not will not affect the development of those assets. It's not a significant fact.

COMMISSIONER CONRAD: You're indicating then, that as of yet no transfer of assets has taken place?

MR. BOYCE: Not yet. Whether or not it will in the future is a legal matter to be worked out by the lawyers, but it is not a business matter in terms of whether or not the assets are developed.

COMMISSIONER CONRAD: Is there an intention to transfer assets?

MR. BOYCE: You are familiar with the Northern Pacific bonds. All of those assets are mortgaged and a requirement of those bonds is that any income from those assets remain with the trustees or be placed into the railroad itself. As long as that – as long as that requirement exists – and those bonds, incidentally, expire in the year 2047 – there is no legal way that we are familiar with to actually occur – to transfer. But I think you may still not be hearing the point that I am making; that is, that those assets – it was never carved anywhere in stone that those assets had to be used for railroad purposes.

COMMISSIONER CONRAD: I hope to develop that further. But let me just pursue this line of questioning, because I am interested in whether or not there is an intention to transfer assets.

MR. BOYCE: As far as we know, at this point, it isn't possible. If at some time in the future it becomes possible, then we would have to make a decision whether or not to do it.

COMMISSIONER CONRAD: In the proxy statement that BN sent to stockholders on the question of the formation of the holding company – I would quote from that, "Management believes that development of the railroad's natural resources and nonrail properties could be facilitated if transferred to the holding company or other subsidiaries of the holding company. If formation of the holding company is approved by the stockholders, it is likely that some of these resources and properties will be transferred to the holding company; although, the extent of such transfers may be limited because of tax considerations." It goes on to say, "Transfer of railroad's natural resource properties may also be limited by certain of the railroad's mortgages which constitute liens on such properties to secure bonds issued by one of the railroad's predecessors."

MR. BOYCE: That's exactly what I am saying.

COMMISSIONER CONRAD: The intention here, it seems to me, is that you intend to transfer assets.

MR. BOYCE: If it can be done. But it may not be possible and it doesn't matter. You see, even if the assets are not transferred from the railroad to the holding company, the other businesses, the coal company, the oil company, the other businesses that are owned by Burlington Northern, can still contract with the railroad for the development of those assets. The point is, the interest that you have as a resident of North Dakota, the interest that the shippers have and a strong Burlington Northern railroad system is exactly that, that if the railroad is strong, if it functions well, that's what counts. Those assets have never been – it has never been required that those assets be required to support the railroad operation.

COMMISSIONER CONRAD: Let me ask you this question: There was a report in the Williston Basin Oil Reporter of September 30 of this year. And I quote, "As the oil and gas subsidiary of Burlington Northern railroad, Milestone has assets that would take years for any other company to attain. A substantial amount of those holdings are in the Williston Basin.

It owns 7.5 million mineral acres and has an additional 1.5 million acres under conditional oil and gas lease. In the Williston Basin, Milestone owns 3.5 million mineral acres.

Its total production is 7,600 barrels a day, up from 7,400 barrels a day in July. It has petroleum (oil and gas) reserves of about 18 million barrels.

Created in mid-May, Denver-based Milestone Petroleum was formed to manage Burlington Northern Railroad's oil and gas interests.

Most of the company's 7.5 million mineral acres have their roots in the establishment of the old Northern Pacific railroad at the turn of the century. As a bonus for building the railroad from Washington State to Minnesota – and as a source of income for the railroad – the Federal Government granted Northern Pacific parcels of land along the railroad route.

The mineral acres are now managed by Milestone." But the assets have not been transferred to Milestone.

MR. BOYCE: That's correct. It doesn't matter.

COMMISSIONER CONRAD: While it's being mined by Milestone?

MR. BOYCE: Yes. It is a legal technicality. It doesn't affect the development of business.

COMMISSIONER CONRAD: Except that the flow of income then may be diverted from the assets that remain attached to the railroad company to Milestone. I mean, that becomes an accounting exercise as to where one places the profits.

MR. BOYCE: That's exactly true. It's an accounting income. The income never flowed from those properties to the railroad. Okay. It flowed to the Burlington Northern corporation, which had divisions instead of companies. We had the transportation division completely separately managed. We had a natural resources division, which had the timber, the oil and gas, the coal. Those separate divisions formed their own operations. Any profit that they generated flowed up to the corporation as a whole and then decisions were made as to where to make the investment. That process – that basic process of individual business earning money, flowing it up to a parent corporation, then decisions being made to invest has not changed.

COMMISSIONER CONRAD: Let me ask you this; Are you familiar with a letter from the office of the Chairman of the ICC, specifically Mr. Bruce Hatton, Director of the ICC, specifically Mr. Bruce Hatton, Director of Governmental Affairs, on this very question?

MR. BOYCE: I have heard of that. I think Larry is probably more familiar.

MR. KAUFMAN: I have read it.

COMMISSIONER CONRAD: Let me just read for you from that letter. "Nonrail income, primarily from natural resources, is extremely important to BN because it has enabled BN to maintain an A credit rating on its bonds by Moody's Investor Service. Any lower rating would have made it extremely difficult for the company to have done any non-equipment financing. For example, during the five years 1976 through 1980 the combined earnings available to cover fixed charges totaled $1,059 million. Fixed charges over the same five-year period totaled $365 million, for a fixed charge coverage ratio of 2.9 to one. Coverage of this magnitude is satisfactory to maintain an A rating. However, if a non-railroad income is deducted from earnings available for fixed charges, the $1,059 million figure would be reduced by $774 million to $286 million, or less than the total fixed charges of $365 million. Rail operations performed better in 1980, generating a fixed charge coverage ratio of 1.30 to one, but that ratio would not have supported an A rating. Additionally, the improved rail earnings might not have been possible without the large investments in rail facilities financed in part by funds from natural resources and from outside financing permitted by the A rating partly attributable to natural resource income."

That suggests to me that any separation of the nonrail income from the railroad would have an adverse effect on the rail operation.

MR. KAUFMAN: It doesn't suggest that to me. To begin with, Burlington Northern, Incorporated is still going to be the entity that goes into the securities market. The same assets are still there, protecting the A rating. I would hope we would get to be a double A rating as the profits of the company improved. I don't think you can have it both ways, that we are definitely for having – using the nonrail assets to contribute to our investment policies or that we're stupid for having invested money in the railroad over the last five years. Either we are going to get out of the railroad business or not. We contend we are not and we contend –

MR. BOYCE: Any securities that are issued now will be issued by the holding company. Any securities that are issued now will be issued by the holding company, not by the railroad. All of that income from all of that land is still available for those same securities. It has not changed.

COMMISSIONER CONRAD: Let me just –

MR. KAUFMAN: Maybe I could clarify it a little bit here. If you separate the assets, all it means is that the coal company is free to have the parent company go into the market, pledge the assets of the coal company for future investment – for future investment capital. In the past, as Mr. Boyce has tried to point out, any revenues that went in as investment into the coal operations or the oil operations had to come from internally generated cash because of the constrictures of the Interstate Commerce Act. All that the holding company means is that they have got more ability to raise capital in the market for more development of the total company.

MR. HARING: Could the securities then be used to finance rail improvements or would they be limited to development of the nonrail investments?

MR. KAUFMAN: They could be used for any investment that the corporation wishes to make if it can satisfy the lenders.

COMMISSIONER CONRAD: How would you make those decisions?

MR. KAUFMAN: In a prudent, businesslike manner.

COMMISSIONER CONRAD: Which would mean you would put them into the highest rate of return investments that you could find?

MR. KAUFMAN: Probably.

COMMISSIONER CONRAD: Given the current makeup of the company, which are the highest? If we can look at the eight – if we look at the eight profit centers that you are proposing to form, which of those eight are the most profitable and which are the least profitable in terms of rate of return?

MR. BOYCE: I think, in terms of overall rate of return, total return on total assets that have been acquired over the years, there is no question that the railroad is the lowest. That's not the point. You don't make the point – you don't make the decision to invest additional money in the railroad based on what you are earning on what's already there. You look at new investment and the decision to make an additional investment to put in, for example, a centralized traffic control system, which allows you to electronically control the switches rather than have the trains run on written orders – that one investment in a particular area of the railroad that has heavy traffic may very well have a return much higher than oil well, so you look at individual projects and you do not look at the total return of the business. And there are many individual projects in the railroad which have good return and will continue to attract capital.

COMMISSIONER CONRAD: How about branch lines?

MR. BOYCE: There are some branch lines which will be rebuilt, where we see a future, where we see traffic consolidating on those lines. There is not enough money there, will never be enough money to rebuild all of the branch lines. We think we know which ones are going to survive. That's why we published the map. We wanted reaction from the people. We want to work with individual people to help decide which branch lines are going to be rebuilt.

COMMISSIONER CONRAD: The trouble I am having – I think the trouble that many people of North Dakota have is that the comments that you're making that a holding company structure simply has no affect on the rail operation is that such things differ from what is recorded in the various ICC reports –

MR. BOYCE: Read the record again. The thing I read and the thing you read – it says, to date. It isn't in the future. That breaks it down – okay. If you want to look at the history of the railroad holding companies, you can find a variety of things that can happen, some of them very bad. You can't from that history conclude that a holding company will or will not do one particular thing. It says that there has been no direct causal relationship between the form of corporate organization and the quality of transportation service. It expresses a fear that there may be in the future, but it says that there has not been in the past. If you want an example of a holding company, look at the Union Pacific. It has been making decisions for years as to where to put its money. It's put a lot into the railroad. You can look at the Sante Fe. It is quite similar, two of the most successful, most well-run. You can also look at the Milwaukee road, which has been held up as an example of a holding company. If you look closely at the Milwaukee road, you will see they had very few assets other than the railroad. They did not really diversify very much. And you might draw the conclusion that they would have been better off if they had diversified further.

COMMISSIONER CONRAD: Let me just repeat, the findings – the ultimate conclusions from the ICC report, "The history of conglomerates in the railroad industry demonstrates that a parent company has ample power to strip its subsidiary railroad of valuable assets, to the actual or potential detriment of the carrier and of its ability to carry out its common carrier responsibilities."

Further, the report, on page 70, indicates that corporate growth has been relatively slow, "but therein lies a basic problem: most railroad-formed holding companies depend on development of former railroad assets for purposes of expansion and growth. The railroads, once divested of noncarrier assets, remain a nongrowth sector of the holding company group. Ultimately, as has already happened in two instances (Bangor Punta and NWI) and as suggested in a third (ICI), divestiture of railroad subsidiaries becomes a probability once the railroad has served its purpose as the basic resource utilized for diversification."

It goes on to say, "Our concern lies in the fact that railroad noncarrier resources and income have been divorced from the railroads in many, if not most, cases without adequate compensation.

As a result, while the stockholder has lost nothing and perhaps has even gained in terms of equity and earnings, the railroad as an instrument of public service has been deprived of wealth accumulated over many years, including resources such as land grants provided at public expense." I only see one way of reading that and, that is, that there is the threat and there is the experience that holding company formation can lead to a deterioration in support for the rail enterprise. And, again, when I look at the letter from the office of the Chairman of the ICC to United States Senator Baucus, which talks about the importance of nonrail income, when I review your proxy statement to stockholders, which allows you to make those transfers to their subsidiaries, I find it hard to not make the conclusion that there is the potential for damage to the rail system that remains.

MR. BOYCE: There is potential without the holding company, too.

COMMISSIONER CONRAD: Yes, that's absolutely true. All of the reports suggest that the holding company structure is — as you know, again, we could go back to the final conclusions. They say, "This opportunity has been found to exist to a significant degree only within those corporate structures in which there is a parent holding company." That's the ICC talking. They are experts in this field.

MR. KAUFMAN: Hardly. The Congress has told them to stop regulating the railroads so much. I might add, in a serious vein, Commissioner, the statement is quite probably true, because absent the holding company's structure, those nonrail assets remain nonincome-producing assets. They don't get developed. The corporations that you cited a few moments ago, Bangor Punta, ICI industries, all of those have had, I am sorry to say, rather poor railroads. They either were in bad market situations, had been mismanaged to one degree or another at various times in their history. The report does not cite the Union Pacific, the Missouri Pacific, Sante Fe or the many good railroads that are properly maintained. We have obviously reached a point here where we can match our quotes with your quotes. Maybe we're at a Mexican standoff. I guess I would just conclude my offering by saying, we'll put the three hudnred forty million dollars of capital investment that we are making in the railroad this year on the table. I can't conceive that I or our other executives are so stupid as to put that kind of money into a venture that we intend to scuttle. I don't know what more you could want, except for the proof that we are putting the money out on the table.

COMMISSIONER CONRAD: I don't think the concern is you are going to go out of the railroad business. I think the concern, frankly, is that you're splitting off the most profitable parts of the enterprise from the railroad operation and that that, ultimately, has to adversely affect the rail operation. I say that to you in all sincerity, that this is the concern across the State. And I think there is good reason for that concern based on my readings of these ICC reports, a letter to Senator Baucus, the stated intention in your proxy statement to split off those profitable assets, the fact that if I look at your annual statement correctly, I find that in four of the eight enterprises, it only accounts for about six percent of your gross business volume, but it accounts for fully thirty-five percent of the profits of Burlington Northern. And if I were making private investment decisions, I would be wanting to reinvest in the highest rate of return projects. And it seems to me, if one looks at a mix of BN, the highest rate of return projects are clearly in oil and coal and are clearly not in rail service.

MR. BOYCE: There are many higher return projects than rail. That's why we are investing three hundred forty million dollars in it. Let me go back. After the formation of a holding company, Commissioner, and ask what there was that would prevent us from doing exactly that, from choosing to place money in the highest return businesses. What has changed? Back when we were Burlington Northern railroad, what has changed?

COMMISSIONER CONRAD: I think the evidence suggests — again, I would repeat what is found in the ICC report.

MR. KAUFMAN: Let me repeat one. I won't repeat. I will toss something new out. In 1977, the railroad lost money. In 1978, the railroad made about eleven million dollars. In 1979, it made about forty million dollars. Last year it made one hundred sixty-five million dollars. And we anticipate we'll make a little bit more than that this year. This is a fine railroad. Mr. Creedy said it was a fine railroad. It is getting to be a better railroad. We seem to have a communication problem here. We're showing you what the spending is and you're giving me government quotes.

COMMISSIONER CONRAD: I am interested in trends as well. T. D. Manace, from Atlantic Richfield Oil, was reported in an interview in the Minneapolis Star daily newspaper on April first, 1981, as questioning the BN's plans to resuscitate the railroad with two billion dollars, to upgrade coal-hauling facilities. It's stated "Under Bressler's leadership, BN slashed projected capital spending in railroad operations during 1981 by 46 percent from the level of 1980. Meanwhile, capital spending for BN's oil and gas activities was up 76 percent."

MR. BOYCE: Yes. And most of that capital spending that was cut was investment in new locomotives. There were a lot of new locomotives bought in 1980 and very few bought in 1981. You know why we have got two hundred locomotives sitting idle? When you have got a lot of excess capacity, you don't buy more. That's why that decision was made. That would have been made by a railroad man just as well as by a man with a background in the oil industry and, in fact, the airline industry and all the other places he has worked.

COMMISSIONER CONRAD: Were there any other capital spending projects affected by that 46 percent reduction?

MR. BOYCE: Yes, there were fewer cars bought because we had about thirteen thousand surplus cars.

MR. KAUFMAN: Wheat shippers haven't been shipping a whole lot of wheat this year. If I could answer that one in a little more serious vein, Commissioner, in 1979, we opened a new line. It cuts across the Powder River Basin, an investment of one hundred million dollars. In 1979, we opened a new coal line through the Powder River Basin in Wyoming, an investment of something in excess of a hundred million dollars. The efficiencies that that gave us cut about two days of cycle time off the movement of unit coal trains. We have got approximately some sixty unit train sets, coal cars and locomotives, in storage this year, not because the coal business has been bad. We are going to move one hundred fifteen million tons of coal this year. They are there because the railroad has gotten more efficient than its own managers thought it would five or six years ago. I can't be responsible for the way a report in a public forum chooses to characterize the capital spending plan. He chooses to use the word "slash." I would use a different word.

COMMISSIONER CONRAD: You have talked about the amount of money that you're investing in the rail operations, three hundred forty million dollars. That's on the table. Maybe some questions are in order as to what kind of projects are being reinvested in. For example, in Appendix D to the Burlington Northern and St. Louis-San Francisco merger order, Volume 360 of the ICC report, it states that in 1977, BN launched a new five-year plan that contemplates capital expenditures of about two billion dollars for expansion and improvements. About half of the total will be for coal-related projects. Could you give us some idea of the three hundred forty million dollar investment that you're talking about, how much of that is coal-related projects?

MR. KAUFMAN: Relatively little because the development for coal has been accomplished, which is also one of the reasons why the capital spending dropped off from six hundred million dollars the previous year to three hundred forty this year.

COMMISSIONER CONRAD: Are you familiar with the Justice Department study that was done on the question of anticompetitiveness that could be created in the coal business as a result of the marriage of BN's very substantial coal resources with its monopoly transportation of those coal resources?

MR. BOYCE: I don't recall that term being used. I don't recall the "monopoly" term being used. Maybe it was. I am familiar with the study.

COMMISSIONER CONRAD: That report raises some interesting questions as they relate to Burlington Northern and what we have just talked about kind of creeps naturally into that subject. It's one of the things we have listed as a question. On page three of the Department of Justice testimony, which was provided – is this the Commerce Department?

MR. HARING: Justice Department.

COMMISSIONER CONRAD: Repeal of 2(C) from the Mineral Leasing Act which prohibits you from leasing Federal coal. This comment is made in the Justice Department testimony. "The results of that analysis were transmitted to Congress last year in the Department of Justice's third annual report on competition in the coal industry. . . . If a railroad with market power over the transportation of coal in particular markets also owned substantial coal reserves in those markets, it could find it profitable to drive up the price of coal by withholding coal transportation services. Monopoly profits that might otherwise be unattainable because of ICC regulation of transportation rates might thus be collected through coal."-At a later point in that testimony, they go on to say, "Only one railroad originating coal in the west, the Burlington Northern, was found to have a significant degree of market power. Consequently, we believe that only the Burlington Northern might have an incentive to act anticompetitively if Federal coal leases were issued to it." I was just wondering if you could react to that.

MR. BOYCE: That was issued when? 1980, wasn't it? Two weeks ago, the Justice Department testified at a hearing on their appeal of Section 2(C), supporting the repeal of that section, made no comments about any problem that they saw with Burlington Northern because there are other provisions in that same Act which deal with the anticompetitive nature of each individual lease sale. I don't know how long you want to keep going on referring to government studies. What we're trying to transmit to you is the way that we, as a company, think. I suggest that's more important to the people of North Dakota than a bunch of studies out of Washington, D.C.

COMMISSIONER CONRAD: That's one of the concerns. You have announced your plans for the future and the plans of the abandonment of half of the branch lines in this State.

MR. KAUFMAN: Not so. Let's be accurate now.

COMMISSIONER CONRAD: Twelve percent of your mileage – of what? The branch lines in North Dakota? How much have you talked about potentially abandoning?

MR. KAUFMAN: We have stated that we intend in the next three years to file abandonment petitions on 423 or 432 – I am not sure which digit goes where – on miles of branch line, which is probably about thirty percent of the system – branch line system.

MR. BOYCE: Twenty-two hundred miles of branch line.

COMMISSIONER CONRAD: How about in the other categories?

MR. BOYCE: We are studying those lines. As I said in my statement, we didn't have to put any of those lines on the map. We could have played it very close to the investigation, simply waited to see what happened; then, when those lines had very little or no business on them, because of development beyond our control on the grain marketing system, then move for abandonment. We chose not to do that, Commissioner. We thought it was best to be open with the people of North Dakota, to let them know how we think the future is developing. As I said today, if we're wrong, we will make changes. If those lines continue to prosper, if they carry more business in the future, we are ready and willing to change.

COMMISSIONER CONRAD: Okay. I think we are going to have to proceed here. We are going to get in the other witnesses who are here so that they can make their presentations. I want to thank both Mr. Boyce and Mr. Kaufman for taking the time to come here and present their testimony. We certainly appreciate that effort.

Next, we'll go with the agricultural panel, Mr. Jim Marsden, Mr. Robert Kadrmas, Mrs. Agnes Zimmerman, Mr. Kelly Shockman, President of the North Dakota National Farmers Organization; and Dina Butcher, Staff Assistant for the North Dakota Department of Agriculture.

I first want to thank the members of the agricultural panel for being here. Given the lateness of the hour, we will try to proceed as rapidly as possible with each of you giving your statements and entering your testimony into the record. Then we will proceed, if there is time remaining this afternoon, to our labor panel. If not, we'll ask them to begin this evening, but, hopefully, we can get through most of this, so we'll start with Mr. Marsden, Director of Public Affairs from the North Dakota Farm Bureau.

MR. JAMES MARSDEN: Good afternoon. My name is James H. Marsden. I am the Director of Public Affairs of the North Dakota Farm Bureau and more commonly referred to as the lobbyist of the organization. I appreciate the opportunity to speak to you today.

In my capacity as the legislative director or lobbyist, I have attended numeorous meetings on the issue of Burlington Northern's railroading of North Dakota in the past few years.

Like many of the others, who have attended those meetings, I have gone away frustrated because more could not be done.

However, in reflection, I do acknowledge the efforts of many who have saved North Dakota farmers millions of dollars over what they would have paid if it had not been for the efforts of the N.D. Wheat Commission, the North Dakota Public Service Commission, and the Upper Great Plains Transportation Institute. There are many of our members who are deeply concerned about statements by public officials that there isn't anything we can do and we've got to accept the inevitable.

Our people have been greatly heartened recently by the efforts of several prominent officials such as Commissioner of Agriculture Kent Jones and you, Commissioner Conrad. They also appreciate the efforts of our Congressional delegation, Senators Mark Andrews, Quentin Burdick and Representative Byron Dorgan.

In answer to the question: "Do land grant railroads serving North Dakota still owe anything to the public for the land and the mineral rights given them by the Federal Government more than a century ago?

You people have answered this in the affirmative and are trying to do something about it.

We have been told that the argument was settled in the 1940's when Congress passed a law recognizing that land grant railroads had paid off their obligations for the free property they received. I have heard testimony recently that seriously questions that and hope that testimony presented at this hearing will clear the air.

I have also been informed that the Interstate Commerce Commission, which regulates the railroads has never considered mineral rights and real estate income when making decisions on branch-line abandonment applications or setting freight rates.

Perhaps that is the reason why the I.C.C. has ruled in favor of the railroads in all but two cases in the last 115 or 117 cases.

In the September 29th issue of the Tribune, two articles appeared on page 15, that were of much interest to many of us. One is headlined "Action urged to save branch lines."

A similar wary note was sounded by Gary Berreth, Director of the State Highway Department's Intermodal Planning and Rail Assistance Division.

"The reality is that a lot of those lines are going to go," he said.

But Berreth offered some hope too, saying that some of the lines the railroads are looking to abandon in the long term could be saved if people start acting now.

This can be done only if the railroad perceives a branch line as profitable, Berreth said.

PSC staff attorney Dan Kuntz said profitability of a branch line is a main factor the Interstate Commerce Commission looks at in determining whether to approve an abandonment application.

Kuntz said if people can show a line is being used, or will be in the future, that is important to ICC.

He recommended farmers and communities find more ways to use their branch lines.

However, "Even if you do use the railroad, there's no guarantee that you're going to keep it," he said. "But if you don't you're going to lose it for sure."

Roger Carpenter, who owns an elevator near Alexander, said BN complains about lack of revenues on branch lines, but he noted that he was forced last year to ship 30 cars of grain to Williston by truck because BN didn't have the cars available.

"This is revenue that could have been derived to BN," he said.

Carpenter also said BN hasn't done anything to keep up the branch line in 15 years.

BN's Dircector of branch line management, Dennis Mcleod, defended his company's approach to abandonment and said the abandonment map is not something that can't be changed.

"All our map was trying to do was project our marketing future, " he said. "If you can work into our marketing system, we want to work with you."

"Our plans are not to abandon the rail lines in North Dakota that can support themselves in the future."

Mcleod was challenged by Tax Commissioner Kent Conrad on why BN wants to split off its mineral interests into a holding company.

Won't this mean less revenue for BN's branch lines? Conrad asked.

Mcleod said a decision to abandon a branch line depends on whether that particular line is profitable, not on how much income BN derives from other sources.

In the other article, "BN seeks better image," we can easily understand why and commend them in their effort.

Basically, their arguments came down to the same statement the railroad made before a state legislative committee last winer: "Trust us."

Our members respond to that statement with another – "We'd like to, but don't know if we can."

The reasoning behind that comment is that there is considerable skepticism as to the real motives of the BN.

The BN officials said forming a holding company, which has been criticized for separating the railroad's land and mineral interests from the railroad operations, won't have any adverse effects on railroad service. They said it was done as the only practical means of being free to raise capital to develop the railroad's resources.

Skeptics say that the proxy statement doesn't reveal this according to their interpretation. I think, in the interest of time, Mr. Conrad, I would like to introduce our President, Robert Kadrmas, for a statement from him. Bob is a full-time farmer and rancher and has a successful operation north of Dickinson. He has been actively involved in church and civic activities and has served on both the school board and the hospital board. He has served as president of the North Dakota Soil Conservation Office and he has served us very capably as the President of the North Dakota Farm Bureau. So I would like to relinquish my chair and have Bob Kadrmas come forth, if it meets with your approval.

COMMISSIONER CONRAD: Absolutely. That's fine. Thank you very much, Jim.

MR. ROBERT KADRMAS: I am Bob Kadrmas. I am President of the North Dakota Farm Bureau. I certainly appreciate the opportunity to speak to you this afternoon.

North Dakota Farm Bureau is a voluntary, non-governmental organization financed by membership dues and organized to provide a means by which farmers can work together to achieve benefits usually denied them as individuals. The approximately 20,000 Farm Bureau member families represent all counties in the State of North Dakota and are an important part of the American Farm Bureau made up of over 3,000,000 Farm Bureau member families from 2,834 counties in 49 states and Puerto Rico.

At our annual convention last December here in Bismarck, our delegates approved the following policy statement:

Railroads were given land and mineral rights in return for providing transportation, therefore, we recommend that the railroads be required to put their profits back into providing their equipment and tracks prior to other investments and further, we oppose the closing of branch lines.

In addition, they expressed their concern over the inequitable treatment branch lines had received in their requests for rail cars. Their feelings were so strong that they even called for an investigation of the matter.

Another statement of concern the delegates addressed was that of more equitable statewide freight rates for shipment of grain by rail.

North Dakota farmers paid $200 million to get their crops to market in the 1980-81 crop year. Freight rates charged to farmers are the largest indirect, not out-of-pocket, expense for farmers! A one percent increase in freight rates costs the North Dakota farmer $2 million dollars.

North Dakota is land locked and farther from deep water ports than any other region in the United States. In addition, we are dependent primarily on one railroad system with its only competition for long haul grain movements being less cost efficient trucks.

Due in large part to lack of competition, the Burlington Northern and Soo Line railroads charge North Dakota farmers higher grain rates than any other farmers in any wheat producing area in the United States. Similarly, the North Dakota grain freight rates are higher and more profitable than freight rates on almost any other commodity.

The Interstate Commerrce Commission has stated that if a freight rate produces 160% of variable cost, a railroad not only recovers all costs associated with moving the commodity, but also receives a profit.

According to cost studies conducted by the Upper Great Plains Transportation Institute and the Interstate Commerce Commission, wheat and barley movements out of North Dakota are extremely profitable movements for the railroads. Here are estimates of variable cost ratios associated with movements of various commodities:

ND Barley	280
ND Wheat	220
Montana Wheat	215
SD Wheat	210
Kansas Wheat	190
Minnesota Wheat	190
Nebraska Wheat	175
ICC Declared Profitable Ratio	160
Texas Wheat	155
Automobiles	150
Lumber	130

It is a fact that North Dakota wheat and barley rates are not only exorbitant but also, that they subsidize rail movements of less profitable commodities.

We have appreciated the fact that unit trains have helped the railroads meet rising demand and somewhat eased shipper costs.

In the September issue of the Wheat Grower, a national publication, Michael H. Karl, Senior Assistant Vice President – Grain, Burlington Northern Railroad Co., St. Paul, Minn. points out that ultimately, the rate savings should be reflected in higher prices for the farmers' crops. This is viewed with considerable skepticism by many of our members.

An increasing number of our members are concerned that the 26 car unit train is only a temporary gesture to shippers and that the Burlington Northern insist on a 52 car unit train only. We strongly urge them to maintain the 26 car unit train and also follow the Soo Line example in granting a reduction on the 3 car rates.

A hot transportation issue in North Dakota facing us now and in the next couple of years is rail abandonment. We are told that not all lines currently shown as subject to abandonment will be abandoned. We wonder if the Burlington Northern listing of so many miles subject to abandonment studies was done for a special purpose.

North Dakota is being singled out by the Burlington Northern to face far more potential abandonments than any other state. In fact, over 25% of all Burlington Northern mileage which is subject to abandonment lies within North Dakota.

We think that 1201.6 miles subject to abandonment studies out of a total of 2,220.94 miles of total branch lines is excessive. We realize that our members who are shippers have a responsibility also to develop a strong enough case against abandonment in spite of the strong odds against them.

Several of our members are urging that the Attorney General's office research the Pacific Railway Act of 1864 to see if Burlington Northern is abiding by the terms set forth in this Act relative to acquisition and future use of the lands deeded to them.

I won't be surprised if resolutions are passed in several of our country Farm Bureau annual meetings this month calling for this step also.

I live in the Dickinson area and in western North Dakota many members refer to the arrogance of the Burlington Northern on the one hand abandoning rail lines – the lifelines of many communities in North Dakota – while sapping the state of mineral resources from lands given to them with the understanding that those resources be put back into the maintenance of the rails.

A blatant case in point is the branch line between Watford City and Fairview and Fairview to Sidney. Lands given free and clear to Burlington Northern to place and maintain those rail lines has produced one of the richest oil finds in North Dakota. Just south of Arnegard on the Red Wing Creek field, eight Burlington Northern wells have been pumping approximately 6,000,000 barrels for seven to eight years. Three of the eight have produced over 1,000,000 barrels.

While the wells have been thriving, the rails have been deteriorating. Although these rail lines may not be on this year's Burlington Northern abandonment design plan, they are being allowed to deteriorate so that the next round the questionable statistics will bear out Burlington Northern's cost effective-abandonment-rationale.

North Dakota has become the dog being wagged by the Burlington Northern tail. It's one thing to swallow abandonments based on profit-progress rationale, but somehow the profit gained from free rights to North Dakota minerals could allow most branch lines to remain functional plus subsidizing subterminal development.

We have become victims of a myth perpetuated to make us believe that the rails are doing us a favor. They are reaping profits of the investment of our ancestors while denying a rightful legacy to our children.

Thank you for the opportunity to appear and express the concerns of many of our members.

COMMISSIONER CONRAD: I would simply make the comment that, perhaps, what you are saying is something that reflects the feeling of many people in North Dakota. I have certainly found that the Burlington Northern predecessor organizations were given nearly one-quarter of the surface area of the State of North Dakota. And because of that, there is a strong feeling that the Burlington Northern owes something to the State of North Dakota and the public which gave them those vast assets. And I have found persuasive reservations about the studies that have been talked about which indicate the railroads have paid for what they have received. I can find nothing that values the minerals. For example, in the study that was done in the 1940's by Congress, which led them to the conclusion that they could end the rate concessions that the railroads were making to the Federal Government. And I frankly do not accept the argument that it is like the Homestead Act which is the argument that railroads will consistenly make, that it is a situation akin to the Homestead or to your buying your own home or your farm. The fact is, these were assets given to the railroad for a purpose.

And as I read the Pacific Railway Act of 1864, I think the purpose was not only to construct a railroad line, but to maintain it. Therefore, I have grave reservations about the suggestion that they have paid for what they have received and can do whatever they will with those assets. I think that sums up in many ways what you have said here today. Do you agree with that, Bob?

MR. KADRMAS: Thank you. I fully agree.

COMMISSIONER CONRAD: Next, we will hear from Agnes Zimmerman, President of the North Dakota Chapter of Women Involved in Farm Economics. Agnes.

MRS. AGNES ZIMMERMAN: I am Agnes Zimmerman, President of the North Dakota WIFE Association and Transportation Chairman for our Local Chapter 1. The testimony that I will read has been prepared by Mary Nielsen, who farms with her husband at Medicine Lake, Montana. Mary is our National WIFE Chairman for Transportation. She couldn't be here today because of their Montana state convention yesterday and today at Lewistown, Montana.

More than one hundred years ago, one of the pioneer travellers who made that romantic journey by rail to the Western Sea, and was affronted by the arrogance displayed by the railroad he travelled on, paused to make a prophecy in his notebook. "Some day in this country," he wrote, "it will be decided that the railroads are to be run for the public, and for their benefit and accommodation. Corporations, monopolies, cliques and combinations may, for a time, oppress and hinder the people, but there always comes a day when the public assert, and in asserting, maintain their rights."

That quote is from a book, "Hear That Lonesome Whistle Blow," by Dee Brown, and it should be required reading for all those in Congress that are – or should be – concerned about the state of transportation in this country! It is well-documented, and is fascinating and shocking – reading!

This hearing is concentrating on the effects of the Burlington Northern forming holding companies, and what it will do to the transportation system in North Dakota and Montana. It is especially of concern where the railroad has a virtual monopoly.

Unfortuantely, the railroads were formed as a business venture, and were encouraged to do so by Congress in the 19th century by the grants of land and other subsidies. Before all the rails were laid, more than 155 million acres – one tenth of the country – were given away to the railroad magnates. Indian tribes were decimated, the buffalo were driven from the Great Plains, millions of immigrants were lured away from Europe and a colossal continental nation was built.

The Pacific Railway Act was generous – it gave the railroads 12,800 acres for each mile of track laid, including all iron and coal deposits under that land, and it permitted it to sell first mortgage bonds to the public. In fact, 2 million shares at a thousand dollars a share had to be sold before construction could begin! The builders of the Union Pacific received $16,000 per mile for its tracks across the level plains, while the Central Pacific received $48,000 per mile when it was building the tunnels through the Sierras.

The siphoning off of funds into other organizations or companies is nothing new. As early as 1864, railroad entrepeneurs organized the "Credit Mobilier" – a holding company to siphon off profits from construction of the Union Pacific. The Central Pacific had its own "Holding company" – the Credit and Finance Corporation. Each mile of track laid turned immediately into money and land.

As early as 1871, a Nebraska newspaper editor recognized his community's growing distrust of the railroads. "People may grumble at the railroad companies," he said, "but they are a necessity of the age. What should be done is, not attempt to destroy them, but to control them by law, and to appreciate their worth."

That seemed just as difficult at that time as it is now. In those days, the railroads simply extended branch lines and evicted settlers, claiming the homesteads as a part of the land grant! Now many of those branch lines are to be abandoned because the traffic on them is no longer profitable, even though those on the lines would like to have the service continued.

It is only in recent years that the true value of those lands given the railroads has become evident. At the time that they were granted, Congressmen had no way of knowing that these lands would yield a multi-million dollar business for the companies. It was never written, apparently, that the intent was for those lands to support the operation of the railroads, but since there were financial subsidies for each mile built, and shares were sold to help finance the operation, it is logical to assume that the intent was there.

In areas where there are more forms of competitive transportation available, the problems being experienced by North Dakota and Montana do not loom so large, and so there is not the outcry that is being heard from agricultural interests and others in these two States. Since we are relatively sparsely populated states, we have less representation in Congress. However, with hearings such as this being held, and more and more publicity being given to the problem, the rest of the country should soon learn of our concern. All citizens should soon realize that the railroads should be run "for the public," and should be made self-supporting — legally — through the use of the profits from the land grants.

Amtrak, ConRail, and the F.R.A. grants to repair the tracks — all are Federally-subsidized. If we can alert the general public of the nation to that situation, then maybe Congress will be forced to act, and remedy the situation. It is not the fault of the railroads that they are acting in their own best interests — it is the fault of the Congress of the United States and the people.

In 1886, the Supreme Court suggested that there should be a Federal Agency to watch over these giant corporations. Scores of railroad lobbyists went to Washington to prevent Congress from establishing the Interstate Commerce Commission. At that time, there was so much national resentment of the railroads, that the will of the people prevailed, in spite of the fact that, in many areas, the railroads were able to control the elections. Not until well into the 20th century was the Commission able to set maximum rates, and then the railroads tried to abolish the Commission, until they gradually came to realize that it might prove a useful shield. The legal counsel for the Burlington observed, "It satisfies the popular clamor for government supervision of the railroads, and at the same time, that supervision is almost entirely minimal. The part of wisdom is not to destroy the Commission, but to utilize it."

The passage last year of the Staggers Rail Act essentially made it easier for the railroads to operate as independent businesses, instead of operating in the best interests of the country.

Many agricultural interests are up in arms with the initiation of the unit train concept. They fear the unknown, certainly but there are so many far-reaching effects of this means of transporting grain, etc., that are unpredictable. The effects on the smaller towns is beginning to be obvious. Present operators of elevators hesitate to update their facilities because of the fear of extinction.

With the demise of those elevators, many farmers will lose their freedom to market as they wish. The likelihood of competition between buyers will be lessened, since farmers will haul their grain to the nearest large facility in order to keep their transportation costs as minimal as possible. We are concerned about the increased margins that will have to be taken by the larger facilities in order to pay for the plants. That amount, in conjunction with the increased trucking costs, is likely — in many areas — to offset any benefits offered by the railroads.

The effect on the number of towns is as yet, unknown. The Great Northern railroad map of 1928 shows about 150 towns across the Northern section of Montana. The present maps show about 1/3 that many left. With the long distances involved in these two states, travellers as well as residents are going to be affected. So many unknowns — taxes, the effect on the school systems, the roads — and on and on — are really causing concern to the states.

The long-term effects are just not readily forseeable — when the bulk of our grain is moved by unit trains in this nation, which is obviously the goal of the railroads — will the lower rates remain in effect? Or will they always endeavor to show as large a profit as possible, with no controls?

The only answer is Congressional action to reverse the law passed in 1945 to ensure that the income from those lands given to the builders of the railroads to make sure that they would be financially stable and serve the country, be put back into the operation of this most important transportation system. In order that Congress realizes the gravity of the situation, we must get the information to the general public. In the cities and states where there is intra- and inter-modal competition, the public has, once again, to be aroused! Millions of tax dollars are poured into a system which is offering less and less and costing more — both for passenger and freight service.

In this time of cutting back Federal Government expenditures, a reversal of the 1945 law, and a supervisory agency to ascertain that funds derived from the land grants are used to support the rail operation, is the only way to make the railroads both profitable and service-oriented.

The concept of holding companies is not new – I understand that the Burlington Northern is the last of the large railroads to take this step. But they are a business, and all businesses do what they have to do to make as much money as possible. Unfortunately, the general public of this country are going to suffer financially more, as deregulated services beome higher.

The railroads are going to object strenuously to this proposal – but while they were "repaying" their debts to the Federal Government in the form of reduced rates, they became financial giants – possibly because the other traffic that they hauled paid more, taking up the slack. So the people repaid the debts to the Government, not the railroads, according to an article in ""Traffic World".

This tremendous change cannot be achieved overnight. Let Congress pass a law that will accomplish it in stages – starting with 1/3 of the profits realized from their land holdings, and gradually increasing that amount over a period of years until the passenger and freight services, plus the maintenance of the tracks is completely self-supporting.

The time has come for the people to decide that the railroads should be "run for the public – for their benefit and their accommodation."

Mary Nielsen thanks you for inviting her to let me present this testimony.

COMMISSIONER CONRAD: Thank you very much. We appreciate hearing from you in her absence.

Next, we will hear from Kelly Shockman, the President of the North Dakota National Farmers Organization. Kelly.

MR. KELLY SHOCKMAN: Commissioner Conrad, ladies and gentlemen, my name is Kelly Shockman. I am reprsenting the National Farmers Organization as State Chairman.

I am a farmer from LaMoure, North Dakota. And there's been an awful lot of talk about liabilities and assets up to this point, Kent. I would like to report here that in my home county, in LaMoure County, there are quite a few farmers that have their liabilities out in the country and their assets in town.

I want to testify primarily about the impact of railroad abandonment on rural North Dakota and farmers in particular. And I'll just read from notes. I don't have a prepared text here. I will try to make it as short as possible, Kent. I think any cost involved in transportation of raw agricultural products ends up in the producer's lap. What I am saying here is that any costs incurred in the production of wheat, grain or any bulk cargo on the farm is always reversed backwards and it ends up in the farmer's lap. The farmer produces millions of tons of bulk products. This primarily is grain; although, also meat and milk – and this is shipped out of state – most of it. I am just doing a little calculating here based on a per acre wheat yield at 30 bushels. Each acre involves eighteen hundred pounds of bulk cargo to be shipped out. I think it goes without saying that farmers need an efficient, easily accessible rail system. Remember here, we're talking about major volumes of bulk cargo shipped out of this State. I think we also have to remember here that as far as agriculture is concerned, we do buy huge volumes of bulk cargo that has to be shipped in; primarily, fertilizer, machinery, fuel. So what I am really saying here in this opening remarks is that railroads are very important to farmers. I guess they are important to all people, but, believe me, we have a vested interest in what happens here as far as Burlington Northern is concerned.

I – I think there is no question, as energy costs go up, that we, as producers, as farmers in North Dakota, will have to depend more and more on rail transportation. I don't think there is any question about that, looking into the future. Now, if farmers are forced to haul only to the main lines – and I am a farmer and rural resident, too – I think we have to consider a couple of important points here. With railroad abandonment, this is what it would be. We would be hauling to the main point on the line. We have to consider the impact of truck traffic on our local roads. Now, we don't have a lot of class 1 roads in my home county. You beat these trucks up and down these class 2 and 3 roads, this is going to mean more money out of our pockets to keep these roads in repair.

COMMISSIONER CONRAD: It would be taxpayer's money, wouldn't it?

MR. SHOCKMAN: Right. From my area to the main line, we would have to add another twelve cents a bushel based on present rates to get this grain into a main line terminal. Another thing to consider is the impact on the rural communities in general with abandonment of rail lines. I wanted to ask – while the executives from Burlington Northern were sitting here, I wanted to ask the question: "Does Burlington Northern receive more revenue from hauling grain or hauling coal? Maybe I can get that answered before I leave today. I am speaking of the farmers. The farmer gets the feeling that, possibly, Burlington Northern is more interested in hauling coal than hauling grain. This is maybe not germane to the issues here today, but this is a common feeling among farmers.

Just a few words on unit train problems. Now, this has been widely publicized as a help or valuable tool to the farmers or the producers – agricultural producers. And the National Farmers Organization has some experience in unit train shipment, but I don't think, at least based on the way it is set up now, this will be of much benefit to the average shipper in the State of North Dakota. And, primarily, the main reason here is time. Now, I don't know how many of you people wake up in the morning and every time that sun rolls up, there is a new interest charge. Interest goes on even at night, but it seems like, in the morning, this is when they start a new tally on it.

We did some calculating and I – I will just read this off. A 26-car unit train of hard red spring wheat is approximately 85,000 bushels. And at a cost of four dollars per bushel, this would be a gross dollar total of three hundred forty-three thousand dollars worth of wheat. Here is where the problems come in. It takes the average elevator in the State approximately thirty days of normal volume to accumulate this much grain. We have to average this out. This number of bushels of wheat has been accumulated over an average of fifteen days. This would be inventory that they held for a 15-day period.

Now, the interest on this three hundred forty-three thousand dollars – at a 20 percent rate, which is very cheap for a warehouse to borrow money at, this rate amounts to one hundred eighty-eight dollars per day. Over thirty days, this is approximately $2,914, but it boils down to a cost of about seven and a half cents per bushel to hold the grain, waiting to get a unit train – 26-car unit. So I don't think there is a – well, I guess, maybe a better way to say it would be that the unit train concept is only probably going to be valuable for the large shipper, mainly the subterminal and the lake terminal and river terminal points. It costs money to carry inventory. And I guess the farmer probably carries as big an inventory as any business in America and doesn't even realize it. It certainly costs money to accumulate inventory to use this unit train concept.

Because of the backward pricing of farm products, any transportation or other costs associated with the production of raw agricultural products ends up right back in the farmer's lap. I will try to illustrate this. Bids for grain come FOB Minneapolis or Chicago minus the freight. Meat is priced FOB New York City minus freight from the farm. It's been said that grain is priced FOB Rotterdam, back to our area. The point I want to make here is that the bill is paid by the producers, so it's very sensitive – rail abandonment – freight rates are very sensitive to our farmers because we have no ability to pass it on. All we can do is belly-ache.

As far as duplicating the cost of building a new complex of these main line terminals to be able to use this unit train concept, I really question the advisability of that, because this, again, comes out of the producer's pockets. We have a system set up here for the transportaition of grain. I think we should probably use it. I think railroad abandonment, as far as – the rumor is probably already a fact. I think, when you look at the condition of the line, the poor hopper car availability to the small shippers, I think, maybe, we're well down the road to abandonment of these local lines. I think, maybe, in closing here, the nature of grain marketing is a problem here. It is a problem both to the farmers and to Burlington Northern. And I – I am speaking mainly of the farmers here. When the market is up, everybody wants to ship grain. When the market is down, nobody wants to ship. So I think, maybe – I just wanted to throw this in here, that, possibly, part of the problem here of maintaining profitable branch lines is locked up in this old marketing system. Right now, today, we're in a situation where nobody wants to use the rails, nobody wants to use the cars. Maybe we should make a change there.

Commissioner Conrad, in his opening statement, said that he wanted to find some answers to the questions that we have here about railroad abandonment, consolidation, and mergers. The thing that really scares me down the road possibly is a – we haven't heard any talk of it – there is a possibility of the merger between Burlington Northern and the Soo. And I did ask this question at a meeting one time. There is nothing in the books as far as this is concerned, but we are concerned about that. The Farm Bureau mentioned the fact that we are a land-locked market, we don't have access to barge loading points or to ocean-going vessels. We are strictly dependent primarily upon rail transportation. We share Mr. Conrad's concern – Kent Conrad's concern and the people's concern of declining service. I think this is probably very sensitive to the rural towns – the abandonment of branch lines. I think what happens here in North Dakota and at the hearings like these, and it happens to railroad transportation in general and to Burlington Northern in particular, is absolutely vital to the long-term interests of the people in North Dakota. I happen to be a farmer deeply involved in transportation, but I think this is going to affect the whole State in the long run. We are not very far from the Milwaukee railroad down here. This really shakes you up. So I think, maybe, for all of us concerned here, this is one of the reasons for the interest in what's being proposed by Burlington Northern, and why Kent Conrad and the various agencies are trying to find some solutions to these problems. Thank you.

COMMISSIONER CONRAD: Thank you very much, Kelly. We appreciate your taking the time, showing the interest to come and testify, once again expressing the concern that I think is felt all across North Dakota. I have certainly found it everywhere I have gone that we have a situation that is critical to the future of our State, the economic health of farmers and small businessmen in small communities that are, after all, a very basic part of the strength of this State. So, again, I thank you for coming and sharing your views on this question.

Next, we will hear from Dina Butcher, who is Staff Assistant to the Commissioner of Agriculture. I would like to indicate that I very much appreciate the stance of the Agriculture Commissioner and his support and assistance on this in this area. It was very lonely when we issued the first report out of our office in June. We were very quickly joined by the Agriculture Commissioner who has taken an aggressive stand and one which is very helpful and which we are very pleased about and want to commend the office of the Commissioner of Agriculture for.

MRS. DINA BUTCHER: You just stole what the Commissioner told me to tell you. Commissioner Kent expresses his appreciation to Commissioner Kent for holding this hearing today. And if I may, a short commercial message. We have heard the ICC mentioned many, many times. And the Commissioner did visit with the Chairman when he was in Washington not too long ago. And he is having his administrative assistant in North Dakota, starting on Monday, for a series of hearings. He will be listening to many of the same concerns that were expressed here dealing with rates and the separation of the land-grant activities. Accompanying him will be Buzz Fitzpatrick, who is the Director of the Office of Transportation in USDA. USDA is looking at the position which they will develop relating to these staggering issues in North Dakota and other parts of the country.

COMMISSIONER CONRAD: Maybe you could share with this audience what that schedule is, becasue I am sure there are people here who would like to attend and people here who would like to transmit that information to others.

MRS. BUTCHER: I bet we would dance well together. You anticipate everything I am going to do. The first part of the agenda on Monday is a state intermodal transportation meeting. (I have got a prompter up there who is just marvelous. I am not just exactly sure.) The first part of the agenda is the state intermodal transportation hearing that has a set agenda and is a committee, as you know, appointed by the Governor to have a broad representation on those problems. That will be at ten o'clock at the Town House. Then, in the evening, on Monday, October 5, at the Holiday Inn in Bismarck, we will be having an open meeting at seven o'clock and will entertain any testimony. Then, on Tuesday, in Watford City, there is a pretty localized activity — there will be a meeting with some people and we are going to have a slight departure from our original agenda. The gentleman from the ICC is prevented from flying, so he and the Commissioner are going to be going by land. The USDA gentleman goes by air and will go to Watford City. The other is going to go to points north, possibly Maddock and Devils Lake, on route to an evening meeting in Grand Forks at 7:30 at the Ramada Inn, then on to Fargo on October 7th for a noon meeting at the Doublewood Inn. That is the rundown on the agenda.

On the historical side, the Commissioner's activities in attempting to bring attention to the transportation problems he perceives agriculture faces in North Dakota, on August 6, he met with Mr. Creedy, whom you have heard from this afternoon, and representatives from departments of agriculture similarly beleaguered in Montana and Minnesota. At that time they drew up a plan of action, more or less, that they could each pursue in their individual states. Commissioner Conrad has launched a similar activity. In a position statement that I will now read, which the Commissioner sent out, along with a letter announcing a series of meetings I have shared with you. He, more or less, outlined what he is going to do. In the letter, he says, "You probably feel as I do that on the issue of Burlington Northern's railroading of North Dakota, we have talked at one another enough; what we need now is action. The frustration I have heard at meetings throughout the state is, What can we do to keep BN from dictating terms not only on rails but also on rates and the whole marketing and socioeconomic structure of the state. The Grain Dealers Association has launched a strong campaign to counter BN's cosmetic approach to covering up the effects of separating its land-grant holdings as it abandons hundreds of miles of rails. The Grain Dealers are acting. We would like to suggest a few more ways we can work together to focus the diversity of efforts already in place in a strong, concerted effort."

That was the introduction to what he expands on in his position statement and action statement.

"It is the position of the North Dakota Department of Agriculture that maintenance of rail transportation is essential to marketing agricultural products. To maintain cost-effective service to farmers, this department will —

1.) initiate efforts to bring Interstate Commerce Commission attention to

  a) the rail-related factors which create inequities in rate structures, inhibiting North Dakota farmers from successful competition in the world market, and

  b) separation of the land grant holdings of railroads from the maintenance and service component of rail transportation;

2.) support U.S. Congressional action to investigate the legitimacy of the rail practices which enable Burlington Northern to neglect and then abandon rail lines while continuing to collect bountiful revenue from the mineral and surface wealth given them for providing service;

3.) encourage the affected states to join together in taking the Burlington Northern through every court in the country if necessary to keep agriculture from being totally subservient to the corporate will and wiles of BN; and

4.) assist the statewide groups already actively seeking a focus for their concerns and frustrations, by

   a) coordinating input to the State Intermodal Transportation Team for recommendations to the Governor and the State Legislature,

   b) organizing a network through the various farm groups to work toward local, state and national attention and action, and

   c) activating and cooperating with the block of western states affected by BN's separation of land grant holdings from rail maintenance responsiblity and abandonment practices, in order to bring about action by Congress, the ICC, and the Courts.

To accomplish the goals set forth in its Position Statement, the North Dakota Department of Agriculture –

– has called a meeting of the western Commissioners of Agriculture at the National Association of State Departments of Agriculture, meeting in Boston on September 20, to focus ag attention in the states which are heavily affected by the land grant separation issue;

– has the Assistant to the Chairman of the Interstate Commerce Commission coming to meet with North Dakota citizens in a series of events across the state, October 5-7;

– has the USDA Office of Transportation Director researching a USDA position on the rail abandonment/land grant sepration issue, also touring the state October 5-7;

– is communicating with all farm and community transportation interest groups to share through their regional and national counterparts the same sort of concerns and need for action on all levels;

– is working with the Governor and Attorney General's Office in seeking opinions on the BN land grant separation issue;

– is cooperating with the Public Service Commission and the Highway Department and legislators, through the State Intermodal Transportation Team, to study problems and make recommendations for state and federal action; and

– is urging the Tax Commissioner's Office to join in this concerted effort to provide a united front.

Thank you for enabling the Commissioner to deliver his comments in abstentia.

COMMISSIONER CONRAD: Thank you, Dina. Thank the Commissioner. We certainly appreciate his stand on this issue.

I think at this point – we're at ten to five and, perhaps, we should break. We will break. I want to ask, before we do that, the members, Jerry Olson – Jerry, can you be here this evening? Al Schuette, can you be here, and Ron?

UNIDENTIFIED PERSON: Yes, we'll be here.

COMMISSIONER CONRAD: We'll put you on the first thing, starting at seven this evening. And, Larry, are you going to be here? I appreciate that very much. We had a very full afternoon. I think we are well on the way to establishing a transcript that will be useful and helpful. I want to thank everyone who has already appeared and indicate we will resume at seven o'clock, same place. And we'll start with the labor panel and proceed with the rest of the schedule until we're completely done.

(Recessed at 4:50 p.m. until 7:05 p.m., the same day.)

COMMISSIONER CONRAD: We're going to start if everybody will take their seat. We are going to proceed very quickly. If the labor panel would be seated, because Ron has to leave to be in Superior, Wisconsin tomorrow, we're going to let him go first, if it's all right with you, gentlemen. Then, we will follow with Jerry and Al. So, Ron, why don't you go ahead.

MR. RONALD MORRIS: Good afternoon – or evening, ladies and gentlemen. My name is Ronald Morris. I am Vice General Chairman of the Brotherhood of Maintenance of Way Employees. I would like to advise you as to what type of work the Brotherhood of Maintenance of Way Employees do. Their work mainly consists of building and maintaining of track, bridges, buildings and maintenance of right-of-way and repairing of machines used in their work.

At this time I would like to thank Mr. Kent Conrad, State Tax Commissioner of North Dakota, for giving the Brotherhood of Maintenance of Way an opportunity to express their findings the hardship in loss of employment and the effect the Burlington Northern holding company, based in Seattle, Washington, will have on its Brotherhood members. Our opinion would be that this holding company was formed to take the money from Burlington Northern railroad mineral rights and use it in other interests; therefore, leaving the Burlington Northern railroad without proper funds to upgrade track on branch lines in the State, as is much needed. These branch lines have been neglected with very few Maintenance of Way people left to maintain these lines.

A section crew today with two or three men are given approximately fifty miles of track to maintain and, by no means, can keep maintenance up on this track. In the early part of the 1950's there would be seven to ten men assigned to a section, with approximately 25 miles of track to maintain.

There is indication that the Brotherhood of Maintenance of Way membership on the Burlington Northern system federation has declined by 600 members since the Burlington Northern holding company was formed. Our opinion is that this is a clear indication that the forming of the Burlington Northern holding company is adversely affecting the welfare of all concerned. And this is only the beginning.

These lines planned for abandonment can and should be repaired. The Burlington Northern railroad has four gravel ballast pits in North Dakota; namely, the Kerry Pit located at Park River, North Dakota, in the eastern part of the state; the Dunseith Pit at Dunseith, North Dakota, near the middle of the State, the Minot Pit at Minot, North Dakota, in the western part of the State, and Falsen Pit near Minot, North Dakota, that would furnish ballast for these tracks.

The Burlington Northern have their own power shovel cranes to load gravel into ballast cars. Therefore, there would not be any need to purchase ballast for these lines under abandonment as they have their own ballast. They also have electromatic tampers that can lift, surface and line approximately one to one and one-half miles of track per 8-hour shift, with a crew consisting of one foreman, one operator and two laborers. The approximate cost of labor and fuel for an 9-hour shift would be as follows: thirty-five dollars for fuel and three hundred twenty-five dollars for labor. Therefore, the labor and fuel cost to lift, surface and line one to one and one-half mile of track would be approximately $335. The cost to load the gravel in the ballast cars would be approximately as follows: The labor for an 8-hour shift and fuel to operate machines to load forty cars of ballast with thirty cubic yards per car – the total cubic yards in forty ballast cars would be twelve hundred cubic yards. It would take approximately thirty cars of ballast to the mile to surface track in poor condition. The approximate cost of fuel and labor for an 8-hour shift to load these cars would be forty dollars for fuel and ninety dollars for labor, making a total cost for loading of $130. This would be at current labor and fuel costs.

The shaping of shoulders and plowing out of excess gravel to the shoulder and dressing track would be done by a ballast regulator-type machine. This takes one man to operate and can complete approximately one to one and one-half mile per 8-hour shift, with an approximate cost of eighty-five dollars for labor and thirty dollars for fuel cost, making a total of 115 per 8-hour shift in the shaping and sweeping, this being the final stage of the track-raising operation.

I did not get into tie replacement or rails as the time I have for this report is limited to allow people in this meeting to make their comments on the Burlington Northern holding company and Burlington Northern railroad line abandonments.

The testimony I have presented should show that the approximate cost to restore these lines would be much less costly than building and repairing the federal, state, county and township roadways to haul the large amount of tonnage that is hauled on the Burlington Northern branch lines. There would be a great cost to the taxpayers of North Dakota if these lines are allowed to be abandoned as Burlington Northern has plans for in the near future.

The people of North Dakota should also be thinking of arranging for some type of subsidy from federal aid or elsewhere to repair these lines as it would be less costly than building and rebuilding tar and concrete roadways to haul these products as the railroad track is there and in operating condition.

I would like to thank all of you for your time and interest in this meeting.

COMMISSIONER CONRAD: Thank you very much, Ron. We appreciate very much the fact that you have taken the time to be here and provide the testimony to us.

Jerry, do you want to take it next?

MR. JERRY OLSON: Mr. Conrad, ladies and gentlemen, my name is Jerry Olson. I am a representative of Minot Lodge No. 99 of the Brotherhood of Railway and Airline Clerks and presently serve as President of the Minot Intercraft Railway Association.

I wish Mr. Conrad wouldn't have broke for dinner. I am a little meaner when I am hungry. But I feel my predecessors this afternoon have given you excellent input on the effect of the formation of a holding company by Burlington Northern will have on the railroad segment of the corporation and what we may expect in the future. I do want to read one comment on holding companies. It seems like we have heard quite a difference of opinion on holding companies today. This one was made by Will Rogers back on March 13, 1935. And it's quite interesting. "Say, did you read what the President said about those holding companies? I wouldn't want my worst enemy to call me names like that. Now, my senators can call each other names, but theirs is all in good, clean fun. They don't really mean it, but the President ain't kidding." What makes it worse, it's true. A holding company is a thing where you hand an accomplice the goods while the policeman searches you. March 13, 1935. Isn't it amazing that our forefathers recognized the threat of holding companies and, apparently, dealt with them some forty-six years ago.

It think I heard someone make the comment earlier today, maybe we need that big stick of Teddy's or possibly FDR when he was in during this very time the statement was made. I believe I can better serve this hearing by keeping my remarks to the adverse effects of branch line abandonment, advise you on how to recognize the beginning of railroad abandonment and what you and I, as citizens of our community, can do to reduce the negative impact. My first item will be tax loss projection. No. 1, the loss of tax revenue on railroad property in the community now served by Burlington Northern -- we have many small towns that will suffer irreparable damage to their local government budgets. Two, loss of tax revenue from Burlington Northern employees who must relocate or seek other employment; again, a disaster to local government budgets.

Three, the additional tax burden to communities on account of upgrading and continued maintenance of present roads to sustain additional truck traffic to transport grain and other commodities. We have already witnessed this type of extraordinary expense to counties in the western portion of our state due to the additional traffic from energy development. We have heard cries of help from them right at this date.

My second item will deal with business loss projection. No. 1, the loss of daily trade generated by farm-to-elevator traffic. Certainly, many of the smaller business ventures in the rural communities are dependent on the sales made to customers who stop in for essentials because they just happen to be in town with a load of grain. No. 2, the loss of railway employment income now spent in the local community. The rail dollar is a hard dollar. This is turned over and over again in a community before leaving. And it's vital to the economy of these small-town communities. No. 3, the loss of the spot grain market to the producer. How vividly I can recall riding with my grandfather to the local elevator and waiting for the noon grain quotation, to take advantage of what we may find, whether it be in the morning or in the afternoon rate. No. 4, the loss of the competitive enterprise in regards to freight rates and service. Many of our communities will be completely isolated from any other transportation than the trucking industry. And don't forget that pie-in-the-sky promise of reduced rates through unit grain trains which can be eradicated by the stroke of a pen. Five, loss in valuation of real estate. The previous factors I have covered can only affect your community in one way, by lowering the value of your real estate holdings.

My third item is environmental impact. Who will reclaim the track beds, what will become of the mineral rights if the railroad is allowed to pull out? Why should farmers' fields remain divided by a band of track land which will be overrun by noxious weeds which are even now prevelant along the right-of-way. Most of you have been up and down the highway on No. 2 to Grand Forks. You have this creeping in of leafy spurge. Believe me, a lot of this type of weed comes right from transportation forms. You see it along the track beds of the railroad also. There was a day when we had a strong maintenance on weed spraying and, of course, at one time, before the environmental impact, we burned our roadbeds, but today this is something to look at. Why should we give up a fuel-efficient transportation system in an era of energy shortage. Each day we hear news commentaries informing us of the power of the Mideast oil cartel, that it must be broken and we must all sacrifice. So why should we sit idle by while Burlington Northern abandons one of few forms of fuel conservation, the transportation of freight by rail.

Each year, regulations are imposed on industry to lower the level of exhaust emission. Why should we give up a form of locomotion that perpetuates this concern.

My fourth item is legal and moral obligations. Burlington Northern and its predecessors developed other segments of the holding company from profits partially derived from the branch lines. In contrast, should not profits from the other segments be used to revitalize the branch lines so that they may become more profitable? Much of the land and its resources now held by Burlington Northern was obtained through federal land grants. In contrast, should not ownership of this land be retained by the railroads as originally granted. Certainly, our forefathers did not envision a holding company at the time this land was granted.

My fifth item is negative attitude by the Burlington Northern. Burlington Northern claims modern technology and equipment make it unfeasible to service outmoded branch lines. In contrast, should not modern-day grain yields obtained through this same technology and equipment enable Burlington Northern to sustain their branch lines? I quote Mr. Dennis Kavinow, Vice President, Operations, Soo Line railroad, taken from the Minot Daily News, Saturday's edition, September the 19, 1981, "Soo had a near record month in August, a model month for railroading." Again, I quote, "Every branch line Soo Line has in the State of North Dakota is profitable and the company has a strong maintenance program for them."

At this time I will focus on the first visible signs the community and the shippers therein may recognize as preliminary preparation for branch line abandonment. No. 1, the establishment of direct service agencies, thereby removing the small town agent that serves you on a personal basis. No. 2, the consolidation of the direct service agencies into a single centralized agency, such as Minot has at Gavin Yard. Now, you have cut off an extension of the marketing arm of a viable business. No. 3, curtailment of 24-hour service at the centralized agency. Although customers at the Minot centralized agency were promised 24-hour service during their Public Service Commission hearing, we are now restricted to 16-hour service. The 24-hour service promise is documented in the transcript of the Public Service Commission Case No. 9609. Yet, today, we do not have this service.

No. 4, the reduction of personnel who serve the customers through the centralized agency. Again, examination of Public Service Commission testimony in Case 9609 reveals the promise of retaining two mobilized vans to serve the surrounding communities affected by centralization of the agencies. Today, we have only one mobilized van serving the entire area. Again, our promises were not fulfilled.

Let me tell you that one van serves some 714 customers. Can you imagine efficiently serving 714 customers with one van that must run from the limits of Williston, North Dakota, west to the limits of New Rockford, North Dakota, east and all the branch lines that run off of that main line. No. 5, the removal of local marketing agents, the arm that solicits and assists the customer in obtaining reliable service. Here again, although Minot is a moderate sized community, we have experienced the removal of the local marketing department. Once we recognize these visible signs, what can we, as an individual or a community, do to reverse this trend. Many of the rulings of the Interstate Commerce Commission are so vague that it's hard to pursue. However, there are some definite criteria. There is the various curtailment of service, such as I have just gone over. Note the quality of the maintenance the railroad performs on the lines in your area. List the discrepancies in regularity of service. Are they still making the same number of weekly runs? Note if they are sticking to a timetable. Can you depend on whether they will be there in a reasonable time frame or is it anybody's guess? How long does a loaded car set before it is picked up? How long a time does it take you to receive a car you have ordered? Document your facts, car initial, number, car involved, the date, the time, and et cetera. When you, as a member of your community recognizes these signs, you have a right to protest. You can do so by writing the North Dakota Public Service Commission, also the Interstate Commerce Commission in Washington, D.C. These agencies have a legal and moral responsibility to protect the public interest. Write your Senators and Congressman, write your Governor, contact your public officials. As a matter of fact, contact any agencies that may be interested. This is how we get results.

Thank you for taking the time to listen to me.

COMMISSIONER CONRAD: Thank you very much, Jerry, for providing that testimony. We heard testimony this afternoon on behalf of Burlington Northern officials that the holding company structure makes no difference to the railroad and to the assets that are left with the railroad. I would like to read into the record an additional portion of the report I was reading from earlier today, entitled "Railroad Conglomerates & Other Corporate Structures," report of the ICC in February 5, 1977, page 71. It indicates – and I quote – "As independent financing units, railroads under the control of diversified holding companies are now limited to the use of internal funds and debt financing to satisfy operating and capital improvement requirements.

The result of this situation is that these railroads must incur an increasing amount of outstanding debt, absent sufficient cash flow to amortize such debt on a reasonably regular basis. Further, even when economic conditions might be conducive to equity financing, the holding company railroads, including prosperous carriers, could not take advantage of the situation. If, as is probable, the carrier's debt to debt plus equity ratio then continues to deteriorate, the vulnerability to economic downturns is increased. The ability to meet fixed charges and pay dividends decreases. Ultimately, the railroad can become a burden to the holding company and a candidate for divestiture, as described earlier. Despite assertions of some holding companies of their capability to assist railroads with their capital needs, there is little evidence of such aid at a time when there is general agreement respecting the railroads' substantial need for capital to meet deferred maintenance and delayed capital improvements. More likely because of the holding company's profit center philosophy, its management's decision on use of capital will turn on unanticipated yields among competing investment opportunities."

I think that's of some interest on the questions that we heard raised this afternoon. Finally, in the conclusion section, which the Burlington Northern representatives read the first sentence of the conclusions and recommendations, I went on to read the next several paragraphs, which I think give a different light on the question. I also would turn to page 74 of that same report and the conclusions and recommendations section and would quote the following: "We are particularly concerned that lands which were granted by the Federal Government to railroads to enable them to fund the construction and operation of their rail lines – or the proceeds from the transfer of those lands or of interests in those lands – have been and will be transferred from the railroads to their parent holding companies at less than fair value. Were the railroads receiving these properties, or their railroad successes in interest, to be deprived of the fruits of these land grants at a time, whether now or in the future, when they are needed to support rail services essential to the public interest, the intention of the Congress in making these grants would be subverted, and today's citizens would lose the benefit of the contract made by their forebearers with the land-grant railroads."

I just think it's important to have that on the record. Al, would you care to testify at this point?

MR. ALTON SCHUETTE: Good evening. My name is Alton Schuette of Bismarck, North Dakota. I am the State Legislative Director for the United Transportation Union and for thirty-five years I have been employed as a brakeman-conductor for the Soo Line Railroad.

Mr. Conrad, thank you for this opportunity to appear today in order that the United Transportation Union may express publicly its concerns over the proposed plans of the Burlington Northern railroad company.

We are opposed to the Burlington plan to abandon many of its branch lines and create holding companies as a means of sheltering some integrally related interests of the railroad company.

The abandonment of the railroad's branch lines will have an immediate and permanent adverse effect upon the citizens of North Dakota.

The long term effect of the move to shelter its mineral interests will also be catastrophic to the business climate of this state.

Before I enumerate the various adverse effects which will result from the Burlington Norther proposals, it may be advantageous to remind ourselves of the railroad companies history. Northern Pacific Railroad Company (now a part of the Burlington Northern, Inc.) was a land grant company. The United States granted to the railroad vast acres in the State of North Dakota. The railroad company in turn used the land as an inducement to immigrants to settle in this state. A large number of our ancestors were enticed into North Dakota by the promise of land and reliable railroad transportation. In these land transactions the railroad retained the mineral rights. The settlers who bought the land gave up these valuable rights in the expectation they would continue to receive railroad transportation services.

Today the descendants of those early settlers will be deprived of basic railroad transportation services under the proposed plans to abandon many of the southern branch lines.

The railroads decision to eliminate transportation services is not due to any decrease in the need for the services, but rather is the inevitable result of its own early decisions regarding deferred maintenance and availability of box car units. Over the years the decision of the railroad which appear to have been motivated by the lure of short term profits have worked to decrease its contribution as a transportation carrier. As few box cars and grain hoppers were available farmers and shippers were forced to use trucks to haul their commodities. In short the railroad chose not to be competitive in the transportation market; a market which was their original corporate purpose. Testimony received before the North Dakota Public Service Commission and the Federal Interstate Commerce Commission over the past years verifies that the railroad's transportation services were and are needed and could and would have been profitable but for the conscious decision of the railroad company not to compete for the business.

Today Burlington Northern seeks to abandon branch line routes as being unprofitable – routes which were made by the conscious decisions of the company itself. As a result many employees will lose their jobs. But it is not only the present maintenance right-of-way crews, clerks, agents and train and engine employees who will be adversely affected. Such a decision also means a loss of future employment opportunities in this state which affects the business economy of the state. At a time when the state is seeking to encourage development of new businesses in this state it should also endeavor to save existing business and employment opportunities.

The beneficiaries of available transportation services are also adversely affected. The farmers and shippers will be forced to increase their use of trucks. The farmers will bear the brunt of increased shipping costs necessitated by greater distances which trucks will cover in order to reach the elevators and warehouses for their produce. In a time of depressed farm prices an increase in production costs may have catastrophic effects upon our agricultural economy. Despite the recent emphasis on our booming energy related economy – agriculture has been and will remain to be the backbone of this state's economic well being. The railroad's abandonment plans immediately damage the economic situation of the farmer so too will it inevitably hurt the state and especially our small communities.

Local and state government units will also bear adverse impacts as a result of the railroad's decision. As transportation services increase over existing township, county and state roads the cost of maintenance will increase. Already local governments are hard pressed to meet the maintenance needs of farm to market roads and bridges. Increased load traffic will only aggravate the problem.

In order to meet the transportation needs of its citizens local governments may be forced to increase taxes to meet the maintenance and rehabilitation needs of the roads, highways and bridges.

The inevitable impact of the railroad's abandonment plans thus falls upon the citizens of this state through decreased employment opportunities, a hindered agricultural economy, and higher taxes.

The Burlington Northern on the other hand will benefit from the sheltering of its mineral interests withheld from the early settlers on the promise of reliable transportation. Just as the Burlington Northern may be credited with the settlement of this state it must also bear the responsibility for creating this burden on our present economy.

The Burlington Northern legally may proceed with its proposed plans. However, it appears that there is a strong moral obligation held by the railroad company towards this state which it helped to settle. The Burlington Northern ought to be using its wealth which is vested in its ownership of mineral rights located in this state to rehabilitate its transportation services rather than to abandon them.

I would urge the state government officials who are courting new businesses into this state to just as aggressively negotiate with the Burlington Northern to maintain its transportation services which are necessary to this state's economy.

I'd like to thank you again for allowing the United Trasnportation Union this opportunity to express our concerns.

COMMISSIONER CONRAD: Thank you very much, Mr. Schuette. We appreciate your taking the time to come and testify and provide your views for the record.

We will now proceed to hear from Mr. Larry Weinberg, Chief Legal Counsel, the Montana Department of Revenue.

MR. LAURENCE WEINBERG: Thank you, Kent, for this opportunity. For the record, my name is Laurence Weinberg. I am Chief Counsel for the Montana Department of Revenue in Helena, Montana.

I would like to begin by thanking Commissioner Conrad for providing this opportunity to appear. The Montana Department of Revenue is responsible for determining the valuation of railroad operating property and allocating this valuation to the Montana counties in which railroad operating property is located. As a result, the Department is concerned with the operation of the Burlington Northern in Montana, especially the question of branch line abandonment, as those operations affect taxes. To the extent that the formation of a holding company will result in or accelerate branch line abandonment, the property tax impact is twofold:

(1) Branch line abandonment results in the direct loss of taxable value.

(2) By placing a heavier burden on the road system, branch line abandonment indrectly places a heavier burden on the taxpayer for increased maintenance and repair of the roads.

The Department at this time does not have any figures to estimate the fiscal impact of the second point. However, it does seem fair to conclude that line abandonment will result in additional use of Montana's road system by heavy trucks. This added use will in turn require more maintenance and repair work, work that is eventually borne by the taxpayer.

Turning to the first point, the loss of tax base, it should be noted that to the extent that a local government in Montana has reached its mill levy limits, a reduction in the tax base means a lower income to that local government; and as we have already noted this lower cash flow will coincide with greater need for services. Where mill levy limits have not been reached, lower taxable value in one class of property serves to shift the tax burden to the other property classes. Analysis by the Department indicates that presently proposed branch line abandonments by Burlington Northern will have an estimated taxable value of $4,892,000, with a resulting tax loss of $1,035,000 for affected local governments. In this connection, I wish to provide you with a copy of a research memorandum prepared by the Research Division of the Department. This memorandum has a more detailed breakdown of the tax impact of branch line abandonment.

In conclusion, it appears that branch line abandonment will place additional burdens on taxpayers. The Montana Department of Revenue believes that the question of the formation of a holding company by Burlington Northern must be examined closely to ascertain the direct and indirect consequences of such corporate activity. To the extent that the formation of the holding company will produce tax impact, the Department of Revenue will provide whatever assistance it can in measuring these effects. The Department will certainly be glad to share our findings with other states.

Again, thank you for the opportunity to appear. This concludes my testimony.

COMMISSIONER CONRAD: Thank you very much, Larry. We certainly appreciate, again, your taking the time to appear and provide this testimony on behalf of the Revenue Department for the State of Montana. As you know, we are analyzing the effect on the tax base of North Dakota not only as it relates to the specific questions on property tax, but also as it relates to the effect on small communities and other income tax and property tax bases as well. So, again, I want to thank you for taking the time to come and provide us with that.

MR. WEINBERG: I just might add one point, somewhat off of the main remarks, but I think the representative of your Agricultural Commissioner expressed a desire to see Burlington Northern taken through all the courts in the land. I think, from my perspective, as Chief Counsel for the Department, I think that's one wish that seems to have already been granted. They seem to be involved in many of the courts of this land already.

COMMISSIONER CONRAD: And doing very well there, I might add. Larry, before you leave, perhaps I could ask you another question that has come to mind. It's my understanding that the State of Montana has a fund which is available to fight Burlington Northern on some property tax issues. Is that — is my understanding correct; and, if so, what is the amount of that fund?

MR. WEINBERG: Well, basically, what we have — I think what you are referring to is an appropriation to support the Department of Revenue's efforts in or for litigation. And I couldn't give you the exact figure. It's in the neighborhood of half a million dollars for expert witnesses to evaluate the true market value of the railroad, basically to appraise the railroad for purposes of that litigation.

COMMISSIONER CONRAD: Is my understanding correct that you're looking at net liquidation values as the basis for that litigation?

MR. WEINBERG: Well, we're — our experts have supplied us with a range of values which they believe may represent the true market value of the railroad. At the lower limit would be a salvage type of value. At their upper limit is what they term a corridor approach to the railroad, which is to value the railroad as a going concern. Right now, basically, the status of the litigation is legal proceedings to compel discovery requests by the Department of Revenue by the State, addressed to the Burlington Northern, that will enable us to — or enable our experts to do the analysis which they feel necessary.

COMMISSIONER CONRAD: Is that an appropriation that you have specifically tied to that litigation?

MR. WEINBERG: Yes, it is.

COMMISSIONER CONRAD: Okay. Thank you very much. Next on our schedule is Richard Backes, House Minority Leader of the North Dakota State Legislator. Representative Backes had a personal conflict and was unable to come tonight. He did provide a statement to be read on his behalf by State Senator Francis Barth, who is the Assistant Minority Leader in the North Dakota Senate. Senator Barth.

I might indicate that before we have this testimony read, that it was Representative Backes who came to me earlier this year and first expressed the concern on the Burlington Northern question and asked me to investigate and analyze and prepare a report on that question. And I am very sorry Representative Backes could not be here this evening because he was the person who kicked off the entire effort. And I think, as everyone knows, nothing had been said about the branch line abandonment proposals that were filed sometime after that date. So Senator Barth.

SENATOR BARTH: Thank you, Commissioner Conrad. I might mention at the outset that the testimony of Mr. Backes — or Representative Backes that I am going to read — I certainly concur with his views, so I am not — I would like to say, I am not reading something that I do not agree with. I think I — I agree with everything in his statement. And I would like to, at the conclusion, provide you with a few of my remarks and observations, if I may. Thank you.

Since June of this year, when I first expressed to you my concern that Burlington Northern's plans to abandon branch lines in North Dakota was an abandonment of the people of this state, evidence has poured in to support my greatest fears.

What I shared with you at that time was the feeling among North Dakotans that Burlington Northern was committing a terrible offense of its responsibilities as a land grant railroad. BN is today reaping millions of dollars from the land grant resources it was given through the land grants of the 1800's. Yet, it is breaking its agreement with the public to use those land grant resources in support of its rail system by neglecting that rail system in North Dakota until the system is beyond repair and must be abandoned out of necessity.

In response, you have worked admirably to solve this dilemma. Facts have been uncovered which suggest that BN has breached its faith with the public and that its obligation, as set forth in its land grants, has not been met, as the railroads argue.

In addition, evidence has shown that Burlington Northern may be in violation of merger accords which require that its land grant assets be used to support rail operations and that BN is taking steps to circumvent stipulations on old Northern Pacific bonds which prevent the formation of a holding company.

The consequences of these wrongdoings on the part of Burlington Northern are beyond imagination in their potential effect upon the state of North Dakota.

The most direct effect will be on our small towns and elevators. As Burlington Northern moves to cut rail service by abandoning branch lines, it cuts the lifeline of the farmer to his market. This saps the strength of the elevators, and eventually, the elevators and towns die.

How are these individuals to compete? North Dakota's elevators are locally owned by individuals or co-ops. These individuals have no equity to finance the construction of subterminals or new loading facilities that are required if they are to survive.

The unit train concept is all for the benefit of the railroad, with little benefit for the farmer. The problems with BN's unit train concept are many. It is grossly inequitable. The fellow living off of the main line will be the big loser. He'll be forced to absorb the costs of time, money and equipment to move his grain from the farm to the main line, while the person living on the main line will bear none of these costs.

The net result of BN's move will be a less efficient market. Burlington Northern's plan favors those large in size: the coast to coast railroads, the international marketing firms, and only those farmers wealthy enough to afford $50,000 tandem trucks to move their grain. The rest of us will be at their mercy. The family farm will suffer.

The intention behind the land grants was for the railroads and the government to work together in building a transportation system into the unsettled West to serve its settlers. It was never intended that once the railroad brought the people into the West, the railroad could then desert those people.

But the Burlington Northern is deserting North Dakota and its small towns, its elevator owners, its laborers, and its farmers. Burlington Northern's exodus from the railroad business began with the end of its passenger service to the state, then service was restricted to car load lots only, then it was service of three days per week only or less and now they're telling us we can only sell our grain if we can fill 26 or 52 one-hundred-ton hopper cars.

This is their idea of service. It may be service in the name of profit, but it is not very good service in the eyes of North Dakota.

There is no question that we have plenty of commodities to ship. We'll provide the business to any railroad that wants to haul — just as long as it lives up to its end of the bargain.

Mr. Conrad, I again want to thank you for allowing me to sit in for Representative Backes. For the record, I live about forty miles southwest of Bismarck. I farm and ranch and have a feedlot. By the way, I have — the Burlington Northern has cut up my feedlot, so I am familiar with the operations of the railroad. But it's — the area I serve is — in the Legislature is the counties of Sioux, Grant and the major portion of Morton County, southern Morton County. And the NP branch line that dissects my farm and ranch is known as the South Branch — known in the Mandan area as the South Branch. This is the area with the portion of the railroad that had to be relocated back in 1969 because of the flooding of the Oahe Reservoir. At that time I felt that was very important. In fact, I worked very hard to get the relocation process moving and to get a new railroad, so to speak, built from a few miles south of Mandan to the town of Flasher.

I felt at that time that the services that it was going to provide were very desperately needed and, also, the potential of coal which at that time was certainly not as great – in great demand as it is now – was very evident because of huge resources of coal in western Grant County. The government chose to take the route of rebuilding this line and spent approximately eleven million dollars to rebuild and relocate this line.

I suffered, certainly, a tremendous hardship in having a section of my property cut up and our feedlot cut up, so to speak, but that's not the point; the point being, I felt it was necessary and made the sacrifice to do this. Now, as I see this yellow sheet of the map which was handed out as we entered the door this evening, those of you who have it with you, if you look at the southwest corner of that area, you will see the City of Mandan and you'll see the main trackage of the main line going west of Dickinson and on into Montana. If you look at that dark line that goes south of Mandan, then west, that's the area I am speaking of. The other two areas – the lines you will see there are the Milwaukee lines which have already been abandoned and are not there. The very tip of southwestern North Dakota is the main line of the Milwaukee, which is the one that leads to Miles City and from Aberdeen to Miles City, Montana. The other area, as you will see, at about the town of Elgin – these two lines meet. And the dark areas, of course, are now considered in category 2 for future abandonment. If you look at what you are seeing there, you are now seeing a major portion in that area that is abandoned. You will see a very significant part of southwestern North Dakota without any rail service whatsoever. It will be totally without rail service. I think the Burlington Northern certainly is in breach of a contract, if that't what it was. I have not seen the contract or the agreement that was made by the railroads at the time the Federal Government or the Bureau – the Corps of Engineers chose to rebuild this line. I think the railroad has an obligation in as much as they do have a portion of new track leading to a coal mine at New Leipzig, which is under lease by the Knife River Coal Mining Company.

I might relate an incident which happened to two representatives and myself; namely, Representative Meyer and Representative Riehl, inasmuch as we were contacted by the residents of the City of New Leipzig. They were told there was going to be expansion of that mine, it was going to be used by the Knife River Coal Mining Company to mine and provide coal for the Heskett plant in Mandan and the excess coal or remainder of that trainload would then be used at a plant that they own in cooperation with another utility in Minnesota; the reason being that the coal could be moved into Mandan. When the new plant at Beulah opens, it would need all of the coal under those conditions they could mine up there. The people were then concerned about what's – how much will this do – if it happens to the community, what will happen – what will we need or what will they need in schools, and so forth. We tried to put together what we thought was an honest and fair evaluation of what could happen down the road. We had to contact the railroad people to get the information. And believe me, it was quite hard to do. But the problem was that we couldn't get an answer. Knife River said they were going to mine, providing they can ship the coal, but a portion of that track – namely, from New Leipzig to Flasher – I don't know the exact mileage. I believe, in trackage, it's forty miles – needed to be rebuilt and reworked. And the cost was somewhere in the lower twenty million dollar bracket. And an arrangement then, as I understand it, arose but has not yet to this day transpired. The mine is being mined by a local miner, providing coal for the local people. And I understand that the reason that mine is not expanded, is not now operating and shipping coal to the Heskett plant in Mandan and moving coal into Minnesota is that Burlington Northern was not willing to upgrade this track so they could haul a 100-ton unit – 100-ton cars and unit trains across the trackage for that forty-three miles; the argument being, as I understand it, the Burlington Northern wanted the Knife River coal people to use their resources, their profits, so to speak, to upgrade this track. And, then, of course, they would give them credit in future hauling. Knife River's argument – I certainly agree with your argument – is that they are not in the railroad business. And I certainly agree to that.

As it happens today, this mine is not being utilized to a tune of about a million and a half tons a year, a loss to the community, and so forth. But I do believe, now, when I see the abandonment – the abandonment plan for the future, I really wonder if Burlington Northern wants to really provide a service or Burlington Northern is really concerned about doing nothing more than pursuing their mineral interests. I am concerned that we're being abandoned, so to speak, in North Dakota. I am concerned that nothing will be done unless we do something as we hear today. If you didn't look at the map, you'll see the abandonment of the Milwaukee railroad. But at one point they meet. There is a tremendous grain area in the New England area. That area could have moved grain on down and gotten to the Duluth ports by going into Aberdeen. If this track is abandoned, then the southwestern part of North Dakota will be at the mercy of strictly the truckers. We will have to – our taxes – can you imagine the roads that we would have to build, not only primary, but secondary roads also, to get this grain and livestock moving – I should say, grain moving either to or from the areas where it needs to be.

I think Burlington Northern is certainly not providing or making an effort in providing a service when, at one point in time, the taxpayers – and the land-grant thing, I certainly agree, was a total gift to these people. And then along – just about twelve or fourteen years ago, the Government invested another twelve to fourteen million dollars in that operation — eleven, fourteen, whatever the case may be. And then we found out we're going to abandon it. My question then would be: Should the abandonment become a reality? Is the Federal Government — do they own the property, the trackage? What about the reclamation? Who is going to go back and put this land back to where it was? I think we have a major concern there. And I think it needs to be answered. These are just — Mr. Conrad, just an observation — not merely an observation, but something that I thought should be brought out. And I would certainly want this to be a part of the transcript, because I feel it's very important to know that if this track is abandoned in southwestern North Dakota, we will be without any trackage, period.

COMMISSIONER CONRAD: I am sure, Senator, you are aware of the confluence of events that is raised concerning not only on your part but on the part of others, that we might find a situation in which the Burlington Northern, as a major owner of coal and as a major hauler of coal, could find itself in a position where it could exercise anticompetitive power in the market. As you know, the Mineral Leasing Act which prevents the railroad or the Burlington Northern from leasing federal coal is being considered now for amendment so that Burlington Northern would, in fact, be able to lease federal coal, which is, of course, important to coal development since the Federal Government has so much of the coal in western North Dakota. Of course, Burlington Northern has a great deal of that coal as well. And if they are allowed to be in the coal business directly, there is a grave concern among some that they would have extraordinary abilities to influence the market. And there is probably no better example than the one you are speaking of; that is, a competitor — potential competitor in the coal business needs rail service to a potential mine site. And they have the ability to serve or not serve that area, thereby eliminating potential competition. That is a concern we've already had entered into the record with some reference to a Justice Department study that relates to the anticompetitive possibilities in the coal business. So I thought I wanted to mention that. We have heard, Senator, a number of times that the railroads have more than repaid for what they received via the land grant. I would turn to the "Public Aids to Domestic Transportation: Letter from the Board of Investigation and Research." which is the study frequently referred to, dated September 19, 1944, that talks about compensation the railroads provided the Federal government for what they received via a rate concession and, also, a calculation that is contained in that report as to the value of the land-grant lands. I would turn to page 119, under the heading of "Net proceeds from land-grant lands plus the estimated value of lands held for sale." I would quote, "The reported net proceeds of $434,806,671 received by the railroads from Federal and State land-grant lands to December 31, 1941, plus the estimated value of $60,684,032 of the remaining grant lands held for sale on that date, give a total of $495,490,703. Of this amount, $440,400,051 is attributable to the Federal grant lands and $55,090,652 to the lands obtained from the State grants." That is the calculation as to the value of the land-grant lands at the time of this study.

I would point out further on page 137 — we should go first to 136, "Data assembled by the Board in its investigation of land-grant problems, which show that the railroads collectively have made very substantial compensation by means of reduced rates on government traffic in return for the grant of lands which were received by certain railroads many years ago. It is estimated that the cumulative total of such reductions from full tariff rates to June 30, 1943, is five hundred eighty three million dollars. The amount of such rate concessions has increased rapidly in the recent period as a consequence of heavy movement of military property in connection with the war effort. The total rate concession mentioned above compares with four hundred forty-four million dollars which includes the reported net proceeds received from these Federal grants plus estimated values of land which are still held for sale. While the rate concessions are greater in the aggregate than the values received by the railroads, it should be noted, in making this comparison, that the larger part of the compensation occurred many years after the bulk of the proceeds was realized; although, this difference in time is significant, data or lacking for any strict accounting for interest on the productive capital thus made available to the railroads. The conclusion seems warranted, however, that the compensation that has been made for these land grants may be regarded as sufficient to discharge any obligations incurred by the railroads taken as a whole."

I first want to go to a number of questions that arise as a result of those calculations. No. 1, whether or not the minerals were adequately valued in those studies; and, No. 2, wehether or not the rate concessions that have been calculated in those determinations were adequate calculations in that they counted all of the rate concessions of all of the railroads, not just the land-grant railroads which were required to make rate concessions. And, further, I would quote from the same report on the separate statement of C. E. Childe, member of the Board. I quote: "On much of the Government traffic, however, the savings are more apparent than real, because the published tariff charges, especially on ordnance and military supplies, are so high in relation to general levels of carload freight charges, that the amount of revenue left to the railroads after making land-grant deductions represents a charge greatly in excess of average." I think that may well suggest that the concessions that are used as the basis for that calculation may be phantom concessions; and that in those areas, where it was clear that Government materials were going to be most of what was hauled, that the rates were substantially above normal rates so that even when the fifty percent reduction applied, they still had rates which were, as this man points out, substantially in excess of average. So I think those are two questions that need to be in the record. They have been raised by many others. The question of whether or not the minerals have been adequately valued and the question of whether or not the rate concessions were real rate concessions or whether, in fact, they were phantom rate concessions.

SENATOR BARTH: Mr. Commissioner, I might point out, I think it's rather significant, yes. I certainly think or agree that the mineral interests of the railroads should be looked at very closely; and that, of course, looking at the BN's, which is, in most – which most of all of it, of course, is there because of the land grant back in the 1800's, but I can recall a piece of legislation we had in the past session of the Legislature, when the attorney representing the Burlington Northern appeared before us in relation to severed mineral acres. And it's been brought out here many times today that the Burlington Northern holds about 1.1 million mineral acres in North Dakota. And it was brought out by their attorney that, of course, that these mineral acres are worthless, they are really nothing, they are just setting there. When I asked him then if the Burlington Northern was willing to return those properties to the surface owners, the answer was very quickly – the response very quickly was, No. Naturally. But I think it's – if we look at what's happening in the State of Montana – Montana's mineral interests, of course, again, are also in coal and oil. I think the railroads – the Burlington Northern certainly has an obligation in providing a service, not forming holding companies. I have an inherent fear that forming holding companies – I heard the testimony of the railroad people today. I certainly do not want to relate the statement – saying it's an untruth. I have heard that statement as such made before. And, low and behold, they become untruths after they developed and have been implemented. I think the mineral interests in relation to what's happening in the mineral business – I am concerned that the mineral interests are undervalued by a tremendous percentage. I might note, also, that it's rather ironic, but when I pick up and I see wells being drilled and permits being issued for test wells in my area and all of the southwestern North Dakota area, the area I am familiar with. It's rather ironic that so many of them are being drilled on land which is owned by the Northern Pacific property. That tells me that there is something moving in the direction to where, "if there is going to be any development, let's go to ours first because it's ours and it's a matter of fact, it's a matter of record." It's not a statement I am making out of context. It's – that's the way it is. That kind of rather bothers me, so I do believe, Commissioner Conrad, that we have been – we do need to look at the mineral interests of the Burlington Northern. And I do believe that their – they should be a part of the entire plan and should be considered inasmuch as they have a valuable asset and which is something that has been granted to the railroads because of the original land-grant privilege.

COMMISSIONER CONRAD: You might be interested in one other observation that was in this report, the Board of Investigation and Research report. There were sixteen million acres still retained by the railroads at the time of this report. They were valued, in 1943, at sixty million dollars, for a valuation of about three dollars and seventy cents an acre. And, perhaps, more interesting is the statement in the conclusion part of the report, which is as follows: "As a condition to the repeal of land-grant rates, it would not be unreasonable to require that the remaining Federal grant lands be restored to Government ownership, except for those which are used in carrier operations as right-of-way or for other purposes." Of course, that never happened. The rate concessions did end and the railroads contend that the end of the rate concessions meant the end of their responsibility as land-grant railroads. I think many find that hard to accept. Again, thank you very much, Senator, for your filling in for Representative Backes.

Next, we will hear from Rod Crowlie, the Transportation Assistant for the North Dakota Farmers Union.

MR. ROD CROWLIE: Mr. Commissioner, my name is Rod Crowlie. Before I proceed, I need to express President Stanley Moore's regret that he can't be here, but circumstances just forbid it. We're pleased to have the opportunity to share our views with you. I want to compliment you on your use of your office in a responsible way to pierce the veil of obfuscation surrounding the very serious issue of branch-line rail abandonment, particularly by the Burlington Northern.

In our attempt – in the Farmer's Union's attempt to understand the issue, we have witnessed the Burlington Northern's efforts to make a case and one of those times was today. And I must say that we are astonished by the bizarre approach that the railroad uses in approaching the question of abandonment.

Now, we think that the approach is bizarre both from a subtantive standpoint and from a stylistic standpoint. Before I proceed with that point, I want to make very clear what the position of the North Dakota Farmer's Union is concerning railroad abandonment. We oppose it. Our policy is that if a branch line is abandoned, then the line and the land that it rests on should be held in escrow by the North Dakota Public Service Commission until the shippers on that line can devise alternatives to preserve rail service. If no alternative is devised, then abandoned lines that were granted the railroad by the Federal Government, along with the mineral and coal rights, should be granted to the present landowners.

The genesis of our policy, which was arrived at in our 1980 convention, was not an attempt at land grab, but a recognition of Burlington's logic of rail abandonment. That is, if the branch line is not profitable to the railroad, then it is of no further use to them and should be gladly relinquished to the landowners in the area, or so it seems to us.

For the sake of the record — and it's been pointed out over and over again today and cannot be emphasized too much — there is, in North Dakota, a crisis in transportation. And the crisis ranges on four fronts; first, reduction in federal aid to highways brought about by the Reagen administration; second, inflationary construction costs; third, decreasing state revenues for highway maintenance because of reduced fuel consumption; and, last, the increased burden placed on the highway system caused by rail abandonment. Now, each one of these fronts squeezes every North Dakota citizen both in terms of tax load and in terms of out-of-pocket expense. Nowhere is this more true than among farmers. The farmer's community life is threatened by abandonment of branch lines, abandoned elevators and a disappearing tax base. In the meantime, Burlington Northern walks away from Maddock, North Dakota, for example, having maximized its profits by separating its rail interests from its mineral interests. It is bizarre.

Keep in mind, now, that Burlington Northern has had a highly profitable time for years on these proposed abandonments, not to mention the greater profitability of the Burlington on the main line as well as on its mineral and timber holdings. Now, it is hard to think that they are in serious financial straits in view of such rewarding ventures. It is bizarre.

Let's look at it for just a quick moment. While Burlington Northern is savaging small farmers in North Dakota and small elevators, the condition of transportation alternatives in the State is deteriorating at an alarming rate. 4800 bridges in the State are structurally deficient, and must be fixed. It costs money, taxpayer money. One in five miles of our national interstate highway system needs replacement or major repair. North Dakota's interstate system does not escape some of this required repair. In addition, the farm community is affected and afflicted by low market prices for grain, high interest rates and out-of-sight fuel and operational costs. The word crisis barely describes the plight of farmers.

Now, in the meantime, Burlington Northern uses its dwindling dollars — if we are to believe its claim about branch line profitability — to advertise throughout the State about its concern for North Dakota. And they tell us, with startling piety, how grave the problem of branch lines are. And, of course, to no one's surprise, they have an answer; that is, they want to stand our marketing system on its ear by shutting down 1,216 miles of track. The only sacrifice they ask of us is to make longer hauls to the elevator. In short, the poultice inflames the boil. It is bizarre.

Curiously, as the Burlington Northern moves inexorably toward gutting our farm-to-market system, the answer to the question of railroad profitability on its branch lines remains a closely held matter by the railroad. The North Dakota Farmers Union is pleased to note that the North Dakota Public Service Commission has taken steps to carefully assess branch line profitability. This question has come up in testimony before and it is a vital question. We can ill-afford to rely exclusively on railroad claims as to their profitability. We have to arrive at some system to get at profitability statistics so that the argument will stop concerning whose figures are more reliable.

Frankly, I was taken aback somewhat by some of the witnesses who seemed to assume that the branch lines are losing money. In various meetings over the state, I have asked Burlington Northern representatives: Is this line losing money? Then I get fifteen minutes of prospective talk about the difficulties that Burlington Northern faces, but I don't hear numbers either that the lines are or are not profitable. So we need to get at that question.

We need to — furthermore, on top of all of the things that have been done by you, Mr. Commissioner, by various other agencies of state government and other concerned organizations, we need still to find further options, at least to examine them. We should not close any option out without careful consideration. For example, I think that the State of North Dakota, and its elected officials, needs to reconsider, to look at again whether the State should not own some of these branch lines or to consider using some of its revenue sources to pick up where Burlington has left us. It may not be the right approach, but it ought not to be excluded out at this point. South Dakota, as a state government, has engaged in this process of owning lines, and has issued bonds to buy abandoned lines. We need to look at what they have done.

Iowa, for example, is another option. It is in the process of establishing a surtax on diesel fuel used by locomotives within the State borders, and then to use that revenue as a way of picking up abandoned lines. Now, I am sure that the railroads are horror struck by such efforts. But it's one that ought to be looked at. If they are going to abandon these lines and there is nothing we can do about it — which, by the way, I don't believe — we need to be looking at these other options. Apparently, Iowa uses branch line acquisition, too. Our State Legislature needs to reconsider its position in the last Legislature regarding cooperatives owning rail lines. The Legislature failed to exempt cooperatives from the prohibition of rail line ownership. And, true to form, Burlington lobbied strenuously against the exemption. Not only is that bizarre, it's outrageous. This is especially true when one considers the Federal money available to co-ops who wish to acquire abandoned lines.

Now, we have all the smarts and energy in this State that's needed to deal with this problem. We need only the will.

One last point, Mr. Commissioner. We note with interest and approval your efforts to remind Burlington of its social responsibility as a business operating in North Dakota. Now, sound public policy cannot ignore the social obligations of enterprises in our community. Just as obviously BN can't ignore — leave the community in shambles as it pursues profit any more than a chemical company can dump its poisonous waste in the community's well water. If the enterprise does not take its social obligations seriously, then public officials must see that they do. That is their trust and their duty.

Now, in view of the bonanza that the railroads have enjoyed from the Federal Government, from citizens — all American citizens, it seems to us that the company is obliged to give serious consideration to their social responsibility. We see no great ground swell in North Dakota — the North Dakota Farmers Union sees no great public ground swell for a return to the age of the robber barons. Certainly, Burlington Northern ought to pause if they are trying to lead us there. Now, even Andrew Carnegie admonished his fellow barons to recognize their social duty to the community. The railroads would do well to take a page or two from Carnegie's Gospel of Wealth.

One last point. I noted here this morning, when Burlington — this afternoon, when the Burlington witnesses were here, they talked about putting three hundred forty million dollars on the table, which makes my poker-playing heart flutter in anticipation, but the question needs to be raised, three hundred forty million for what? How much to branch lines and improving the branch lines?

Thank you very much.

COMMISSIONER CONRAD: Mr. Crowlie, I appreciate your taking the time and testifying and providing us with that point of view. I noted with interest your suggestion that the State should at least evaluate state ownership of branch lines. And I would simply make the observation that some have said that we don't want to get into a second round of land grants, that we once gave away a quarter of this state — or nearly a quarter — for the purpose of supporting the rail operation; that according to the latest annual report of Burlington Northern, they now hold 555.4 million proven and probable reserves of iron ore and taconite, coal reserves of 14.7 billion tons, 15 million barrels of proved developed and undeveloped reserves of oil, 25.7 billion cubic feet of natural gas. And those enormous resources were given to them for a purpose. That purpose was to support the construction and maintenance of a rail operation. And many believe that that public purpose ought to continue, that the argument that they make that they have paid for everything and that they are now free to invest their dollar wherever it gives the greatest return ignores the staggering wealth and resources they were given for a public purpose; and that because they were given these enormous resources, that they have some responsibility to use them to support a rail operation, even if it does not provide the highest rate of return for their enterprise.

And I did want to make that observation. I have heard many times — they will say, We don't want to get into a second land grant. We have done it once. Once ought to be enough to get the job done.

MR. CROWLIE: I would hope, if the State of North Dakota acquired rail land, it wouldn't turn around and give it away again.

COMMISSIONER CONRAD: Very good. Again, we thank you.

Next we will hear from Al Austad, Assistant Legislative Representative from the North Dakota Association of Rural Electric Cooperatives.

MR. AL AUSTAD: Thank you, Mr. Conrad. I would like to mention that we welcome the opportunity to express our views on the current situation we have. I think it's compatible with the times we are in, compatible with the times we're facing nationwide. For many years, we have heard groups telling us how wonderful free enterprise is and how great we would be if we got government off our backs. I think we are looking at a subject today which is: What happens when you get the Government partway off your back? We are going to pay for that quite significantly. We are reacting today to the Federal Government's attempts to free an industry from regulation. Again, we're going to pay very dearly for that freedom.

In the last session of the Legislature, there were a number of pieces of legislation introduced which would have given the State a tool to deal with many of our current problems. Unfortunately, by the time it was passed, it was of little use. The major opposition to the bills came from the railroad industry. None of the bills would have been detrimental to the industry. They would have helped us help ourselves, essentially. However, by the time the legislation was signed by the Governor, it is of little help. One has to wonder why the time and the effort of the rail industry to defeat this self-help legislation in the State. It would be interesting if we had an in-depth study of what the railroads earn, what they own and what they pay in taxes in the State of North Dakota. I would probably hazard a guess that they would pay far less in proportion to what farmers pay. Perhaps we should attempt to buy their property at the same level they claim its value is at tax time.

As an aside, Mr. Conrad, the value of some of this land — an acre of land that's on the railway right-of-way in Monango — a rather small industrial city south of Jamestown — is worth about twenty-five hundred dollars an acre. According to the rail figures, it would be interesting to see their value when they are paying their taxes.

We are going to see a new image of the Burlington Northern in North Dakota. I think we will see one that we, in all likelihood, will not appreciate very much. I think the BN is going to make a serious attempt to maximize its profit, to have the highest return possible to its stockholders. The new president is a money man, a money manager, a man who came from an energy company. I don't feel that they can sell to their stockholders that we need service in the State of North Dakota when their stockholders want money. If you have a limited amount of funds to work with and the railroad is making ten percent on a branch line but can use that money in the energy industry and make twenty percent, where is the money going to go?

From the BN's point of view, we understand what they are doing. The holding company of the Penn Central is an example. The holding company of the Milwaukee is another. Both are very viable, substantial companies in today's economy; yet, the railroads that are associated with them are in trouble. There is very little we can do but holler about the moral outrage. Unfortunately, now, we have to holler all the way to Seattle rather than the Twin Cities. We could explain their move somewhat facetiously by saying that they made it so we could not complain about those eastern interests running our state. However, we are on the verge of losing control of our marketing system. We have the system, essentially, being decided upon by the rail industry. They can determine to what market we sell our farm products, at what time and at what price. We have very little voice in this decision any longer.

We need a state legislature that will take hold of the issue and give us some tools, one that will not be swayed by the rail industry. Hopefully, we can accomplish much of our remedies in the next session. Many of our problems have generated themselves in Washington and there appears to be little opportunity to accomplish much there.

What part of the new image of BN will be to listen and take heed of our problems? In the immediate future, we need time. Even three years is too short of a time. Perhaps a state-operated rail system is not as far-fetched as it once was. We could operate as efficient as the Milwaukee or the Penn Central and still have service.

I don't have any long-term solutions. It seems, however, that the present environment is good for only one side and bad for North Dakota. It appears that we're moving backwards a hundred years to when the states individually had to enact the Granger laws and eventually led to the ICC regulations. Perhaps, Congress, who allowed us to get into this mess, can use their wisdom to get us out or at least their ability to clean it up.

I would like to thank you, Mr. Commissioner, for the opportunity.

COMMISSIONER CONRAD: Thank you very much, Mr. Austad. We appreciate your remarks.

We're going to take a short break so our transcriber can have a break. And then we will end with Mr. Ray Meyer, representing the Dakota Resource Council, so we will take a very short five-minute break here and return.

(Recess taken.)

COMMISSIONER CONRAD: We now have Mr. Ray Meyer on behalf of the Dakota Resource Council to provide their testimony. And, perhaps, you could proceed.

MR. RAY MEYER: Thank you for this opportunity to testify. For the record, my name is Ray Meyer. I farm and ranch in Grant County, North Dakota. My testimony this evening is on behalf of the Dakota Resource Council, a group of farmers, ranchers, and others working on issues of energy development and agriculture in our state. In addition to a general membership across the state, the Resource Council works with eleven affiliate groups, organized at the county level, which deal with issues of local concern. One such group is the Grant County Resource Council, of which I am the chairman.

In looking at the future of North Dakota, the Dakota Resource Council firmly believes that the energy boom we are experiencing must not be allowed to harm the health of our agricultural resources — air, water, land, communities, and families. It is with this philosophy in mind that I am presenting the views of the Resource Council on Burlington Northern's responsibilities as a land-grant railroad.

Branch line abandonments are the immediate problem at hand. But it would certainly be a mistake to look at the situation of the branch lines in isolation from the broader matter of Burlington Northern's role in our Northern Great Plains economy.

I know how the people of this state would react if a land-grant college like NDSU suddenly announced that it was giving up its agricultural experiments, quitting its extension work, and wasn't going to teach any more agronomy classes. Everyone takes it for granted that the land given to NDSU was given for a reason. The benefit that the University gets from that land implies an obligation to serve the people. There is no way to separate the benefit from the obligation.

But that is exactly what Burlington Northern is trying to do. By forming a holding company, BN is telling us that it has separated its land and mineral holdings from its obligation to provide service. The company is asking us to pretend that there is no longer any link between the benefit and the obligation.

We in North Dakota have already had our share of bad experiences from large corporations. Fortunately, we've been spared some of the extreme problems which other states have had, such as the bitter lessons Montana learned in decades of domination by the Anaconda Company, which for years owned most of the major newspapers, directed the votes of politicians, and basically ran the state out of its company offices.

Still, we have learned a few lessons about corporations. We know that a corporation does not have a conscience. It only has a corporate headquarters and a legal division. A corporation can not talk from the bottom of its heart. It can only talk on the basis of its bottom line. Finally, a corporation, if it has any respect whatsoever for its bottom line, never looks at a single aspect of its operations except as it relates to the big picture. That's why, if we expect to have any success in dealing with companies such as BN, we've got to look at that big picture ourselves.

In Burlington Northern's case, what is the picture that is being painted? What is the link between the branch line abandonments and other new developments, like the holding company, or BN's plans to develop its coal? I won't pretend that I can describe it completely for you, but I would like to talk about one thing which may not be famliliar to everyone here. It is a story which is rapidly unfolding in Washington, but which has not broken in the North Dakota press as of yet.

This story has to do with about 1,165,000 acres of land in North Dakota under which Burlington Northern has coal rights. As you know, this coal came to BN as part of the land grant to the Northern Pacific. Now that a Holding Company has been formed, this coal is owned by the coal and minerals affiliate of the Burlington Northern.

The affiliate, which is based in Billings, would like to develop this coal. Unfortunately for BN, the coal is spread out in a checkerboard pattern. Many of the squares which BN would like to get to fill in its holdings are owned by the Federal Government, and ever since the Mineral Leasing Act of 1920, the Feds have not been allowed to lease the public's coal to land grant railroads.

The section of the Mineral Leasing Act which BN wants changed is Section 2(c). On September 11, the president of BN's coal and minerals affiliate was in Washington, asking a Senate subcommittee to change the law so that his company could begin getting hold of Federal coal.

Now, what in the world does this have to do with branch line abandonments? To us the connection is pretty clear. By dividing up their company, BN is going to make sure that the profits on coal don't have to support the rail operations. Of course, the coal activities BN is looking at — strip mines and synfuel plants — will require huge amounts of capital, capital which, in our opinion would be better spent keeping these branch lines open. All in all, what we're seeing is BN, the caterpillar, going into its holding company cocoon, and coming out as a full-fledged coal company, with an appetite for public land and public coal that's gotten larger than ever. Does this sound like a science fiction horror movie? A little too far-fetched to believe? Well, here is a direct quote from the testimony of Bruce Ennis, President of the coal and minerals affiliate of the Burlington Norther, testifying before a subcommittee of the Senate Committee on Energy and Natural Resources, on September 11, 1981:

"We believe that we are the kind of coal company which should be encouraged to own and develop federal coal leases. Our company is a permanent resident of Montana. As such, we are one of the few coal companies actually headquartered in the western coal fields. Unlike many coal companies, we own much of the resource we hope to develop. Our closeness to the workplace and our position as a resource owner ensure that we will not mine and move on; Montana and the Upper Rocky Mountain Region is our home and will be for years to come. It will be treated as our home as we conduct our coal development activities."

Do these promises sound familiar? Will the Burlington Northern be a better neighbor as a coal company than it has been as a railroad?

I'll leave the answers to these questions up to you.

In conclusion, the Dakota Resource Council wishes to go on record opposing any changes in Burlington Northern's structure which would enable it to neglect its rail services while expanding its mineral activities. The Council also opposes changing the Mineral Leasing Act to allow land-grant railroads to lease Federal coal. In general, our position is that the number one priority of the Burlington Northern should be its rail activities. BN's mineral activities should support these railroad operations, not compete against or replace these public services.

That was the intent of the Federal Government when they gave the land along with the mineral rights to the railroad. If BN is allowed to abandon these lines, then they should also forfeit the mineral rights in the areas they have chosen no longer to serve.

When our grandchildren see the BN emblem, I want them to see it on the side of a rail car, not a dragline.

For the record, I am submitting a copy of the full text of the Dakota Resource Council's position on the Burlington Northern, adopted by the Council's board of directors on July 13, 1981.

Thank you.

RESOLUTION ON THE BURLINGTON NORTHERN

Adopted by Vote of the Dakota Resource Council's Board of Directors – July 13, 1981.

WHEREAS rail service in rural areas is vital to the agricultural economy;

AND WHEREAS the land-grant railroads were provided with significant amounts of public land and minerals as an incentive to extend rail service in the West;

AND WHEREAS Burlington Northern is currently planning to abandon a number of branch lines in North Dakota;

AND WHEREAS Burlington Northern is currently reorganizing its operations to permit a separation of its transportation and minerals activities;

AND WHEREAS legislative changes in the Mineral Leasing Act have been proposed which would allow Burlington Northern to lease federal coal;

THEREFORE BE IT RESOLVED THAT the Dakota Resource Council opposes any changes in Burlington Northern's structure which would enable it to neglect its rail services while expanding its mineral activities;

BE IT FURTHER RESOLVED THAT the Dakota Resource Council opposes any change in the Mineral Leasing Act to allow land-grant railroad leasing of federal coal;

BE IT FURTHER RESOLVED THAT the Dakota Resource Council believes that the number one priority of the Burlington Northern should be its railroad activities; Burlington Northern's mineral activities should support and complement its railroad operations, not compete with or replace these vital public services.

COMMISSIONER CONRAD: Thank you very much, Ray, for providing that testimony. Is there anything further that you would like to add or Mr. Nace would like to add? We can certainly include it in the record at this point.

MR. MEYER: I think that concludes our testimony. Thank you.

COMMISSIONER CONRAD: Thank you very much. We're right at nine o'clock. Now, that's a well-run hearing, six hours of hearings and we wind up right on the hour that we had projected, so I will close the hearing.

What we intend to do is to have a transcript prepared of the hearing today and then we will prepare a summary report which will be made available to other government agencies, be made available to the representatives of the groups that have testified here today and, also, will be made available to others who are interested in the kinds of testimony that has been provided. I want to once again thank everyone who has participated today. I know some of you have come long distances and gone through some sacrifice to be here. And I also know the kind of work and effort that goes into preparing testimony for a hearing like this. So, again, I want to thank everyone who has participated. I appreciate it and I think we have gone a long way towards putting together a record that can serve as a reference point as this debate unfolds. Thank you very much. (Applause)

(The hearing was concluded at 9:03 p.m., the same day.)

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA
GREAT FALLS DIVISION

THE STATE OF MONTANA
Plaintiff,
v.
BURLINGTON NORTHERN, INC.
Defendant.

Civil No. 90-58-G.F.

COMPLAINT

Comes now the Plaintiff State of Montana and in support of this claim for relief, on its own behalf, and on behalf of the classes hereinafter alleged, and as parens patriae on behalf of all injured natural persons within the jurisdiction of the court, and demanding a trial by jury, alleges and represents to the court as follows:

I.

Identity of Plaintiff

This action is being brought by the State of Montana, by and through its Attorney General Mike Greely on behalf of the State of Montana, its governmental entities, on behalf of classes alleged, and natural persons residing in the State of Montana as parens patriae pursuant to the authority vested in him by law as the Attorney General of the State of Montana, Section 2-15-501 Montana Code Annotated, Section 4(c) of the Clayton Act 15 USC 15(c) and the common law.

II.

Identity of Defendant

The Defendant Burlington Northern, Inc. is a corporation, incorporated in the State of Delaware doing business as a rail transportation and resource development company within and without the State of Montana in both intrastate and interstate commerce.

III.

Venue

Venue lies in this court pursuant to Section 12 of the Clayton Act, 15 USC 22 and 28 USC 1391 and 1392. The Defendant can be legally found doing business within the State of Montana and the claims herein set forth arose in the State of Montana as well as elsewhere.

IV.

Jurisdiction

This court has jurisdiction of this matter pursuant to 15 USC 4, 15 USC 25 and 28 USC 1337.

V.

Nature of Action

This action is brought pursuant to Section 4 and 16 of the Clayton Act 15 USC 15 and 15 USC 26 to redress injuries sustained by Plaintiff and those it represents as a result of violation by the Defendant as hereinafter alleged of Section 1, 2 and 3 of the Sherman Act, 15 USC 1, 2, and 3.

VI.

Co-Conspirators

Various individuals and entities not named Defendants herein at this time participated in the violations hereinafter alleged and performed acts and made statements and writings in furtherance thereof.

VII.

Class Action Allegations

Pursuant to Rule 23(b)(3) of the Federal Rules of Civil Procedure, Plaintiff State seeks to represent a class of

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legal persons similarly situated. The class consists of all persons and entities within the State of Montana who had any ownership interest in, taxed, were employed by, or did business of any kind or character with the Chicago, Milwaukee, St. Paul, and Pacific Railroad Company. The class includes but is not limited to the State of Montana and all its political subdivisions, school districts, municipalities, counties, public hospitals, university units and other governmental units, the former employees of the Chicago, Milwaukee, St. Paul, and Pacific Railroad Company, and business entities and private persons doing business with the Chicago, Milwaukee, St. Paul and Pacific Railroad Company.

Plaintiff is a member of said class; its claims are typical of the claims of all the class members, and it will fairly and adequately protect the interests of the class.

The class is so numerous that joinder of all members in this action individually is impractical. At a minimum it consists of several hundred governmental entities and several thousand individuals and business entities.

Questions of law and fact common to the members of the class predominate over any questions affecting individual members. The common questions of fact include the existence of the conspiracy as alleged and whether the members of the class were injured by the conspiracy alleged. The questions of law common to the members of the class include the legality of the conspiracy as alleged and the liability of Defendant to class members for injury to their business or property interests.

The claims of Plaintiff are identical to the claims of the other members of the class, and the defenses of the Defendant, if any, will be identical with respect to each and every member of the class.

A class action is superior to other available methods for the fair and efficient adjudication of this controversy and will prevent a multiplicity of suits that might otherwise occur.

VIII.

Facts Regarding Defendant Income and Organization

During the year 1978 the Defendant owned property valued at One Billion Five Hundred Thirty-four Million, Six Hundred Four Thousand, Two Hundred and Fourteen Dollars ($1,534,604,214.00) of which Two Hundred Forty Nine Million, Forty Five Thousand, One hundred and Thirty-eight Dollars ($249,045,138.00) was located within the State of Montana. That in that same year the gross amount of its receipts derived from its business transacted within Montana totalled Three Hundred Forty Five Million, Eight Hundred Thirty-nine Thousand, Seven Hundred Fifty-one Dollars ($345,839,751.00) and its gross receipts nationally were Two Billion, Sixty-five Million, Nine Hundred Sixty-two Thousand, Four Hundred Fifty-eight Dollars ($2,065,962,558.00). The amount of its stated capital at the end of 1978 was Six Hundred Eighty One Million, Eight Hundred Sixty Four Thousand, Six Hundred Ninety Nine Dollars ($681,864,699.00). As of February 28, 1979 it had Seventeen Million, Three Hundred Eighty Two Thousand, Five Hundred Thirty Seven (17,382,537) issued shares of capital stock.

That as of April 5, 1979 its Board of Directors consisted of the following persons:

Royal D. Alworth, Jr.	1605 Alworth Building Duluth, MN 55802
Donald C. Dayton	4124 IDS Center 80 South 8th St. Minneapolis, MN 55402

Charles Devens	265 Franklin Street Boston, MA 02110
Robert W. Downing	W. 214 High Drive Spokane, WA 99203
W. John Driscoll	2100 1st National Bank Bldg. 332 Minnesota St. St. Paul, MN 55101
Mary Garst	Box 77 Coon Rapids, IA 50058
Robert M. Hendrickson	1285 Avenue of the Americas New York, NY 10019
Pemberton Hutchinson	2500 Fidelity Building Philadelphia, PA 19109
N.M. Lorentzsen	176 East 5th St. St. Paul, MN 55101
Louis W. Menk	176 East 5th St. St. Paul, MN 55101
Philip H. Nason	E-1220 1st National Bank Bldg. 332 Minnesota Street St. Paul, MN 55101
Paul L. Parker	Box 1113 Minneapolis, MN 55440
Bruce M. Rockwell	Box 5168 Terminal Annex Denver, CO 80217
Gerald C. Ryan	Box 388 East Grand Forks, MN 56721
Robert B. Wilson	1033 American Bank Bldg. 621 S. W. Morrison St. Portland, OR 97225

At the same date its elective officers with position held were:

Louis W. Menk	Chairman of the Board
N. M. Lorentzsen	President & Chief Executive Officer
C. R. Binger	President, Resources Division
T. J. Lamphier	President, Transportation Division
Frank H. Coyne	Executive Vice President Finance and Administration
F. S. Farrell	Vice President - Law
J. C. Ashton	Vice President and Secretary
R. C. Burton, Jr.	Assistant Vice President, Financial Planning and Treasurer

That the funds derived from the Defendant's business activities, the products produced by it, the railroad trains run by it, the stock sold by it and dividends paid thereon all flowed or moved in interstate commerce, and the alleged illegal acts herein complained of had a direct and substantial impact on the flow or movement of such items in interstate commerce.

IX.

Facts Constituting Antitrust Violations

In 1970 the Interstate Commerce Commission approved the merger of the Northern Pacific Railway Company (NP), the Great Northern Railway Company (GN) and the Chicago, Burlington and Quincy R. R. Company (CB&G) and the Pacific Coast Railroad Company in what is known as the Burlington Northern Merger Finance Docket No. 21478.

X.

As an integral part of that merger and as a specific condition thereof, and for the purpose of strengthening the competitive position of the Chicago, Milwaukee, St. Paul and Pacific Railway Company (CMSP&P), the Interstate Commerce Commission granted to the CMSP&P eleven gateways into the merged lines including the following:

Bozeman, Montana
Butte, Montana
Fargo, North Dakota
Great Falls, Montana
Judith Gap, Montana
Linton, North Dakota
Miles City, Montana
Missoula, Montana
Seattle, Washington
Spokane, Washington

Tacoma, Washington

XI.

Immediately before and after the said merger became effective, the Defendant Burlington Northern Railway Company began a secret plan and conspiracy to eliminate any competitive advantage to CMSP&P that may have resulted or been the effect of these Interstate Commerce Commission gateway merger conditions.

XII.

The Defendant Burlington Northern Railway Company immediately upon the merger becoming effective, instituted a program of elimination of merger related short hauls known as Action Program No. 1052 under which they identified CMSP&P short haul shippers through the gateways and then went to those shippers and by various means induced them to terminate usage of the CMSP&P, and to use instead the Defendant Railway.

XIII.

In addition to the Action Program No. 1052, the Defendant Burlington Northern committed other acts calculated to eliminate any competitive advantage the CMSP&P may have initially had as a result of the Interstate Commerce Commission Gateway merger condition including refusing to cooperate with the Milwaukee even when such cooperation may have been to the advantage of the Defendant itself.

XIV.

The management of the Defendant was aware and had been advised by legal counsel and/or others that such activities as heretofore alleged were improper and illegal, and notwithstanding such advice they proceeded to do the same.

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XV.

The acts of Defendant under the foregoing circumstances were not exempted from the antitrust laws of the United States of America and were in fact in restraint of trade or commerce and attempts to monopolize in violation of Sections 1, 2, and 3, of the Sherman Act 15 USC 1, 2, and 3,

XVI.

The aforesaid acts of Defendant had the direct result and effect of eliminating and restraining competition and creating a monopoly which in fact has now occurred with an ultimate resultant increase in prices to the Plaintiff and those it represents, as well as a loss of tax revenues from the CMSP&P and a loss of income to employees of the CMSP&P, all to their damage in a yet undetermined sum but in excess of millions of dollars.

XVII.

Plaintiff contends that the running of any statute of limitations herein has been suspended and tolled with respect to any claim of the Plaintiff and those it seeks to represent and any damages to them as a result of the acts of Defendant alleged herein and with respect to Plaintiff's right to injunctive relief, by virtue of the doctrine of fraudulent concealment and the doctrine of equitable estoppel in that:

a. Defendant and co-conspirators through various devices and techniques, fraudulently concealed the existence, of the unlawful activities alleged herein and,

b. Plaintiff and those it seeks to represent had no knowledge of such unlawful conduct until some time shortly before filing this complaint or of facts which might have led to the discovery thereof with the exercise of due diligence.

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XVIII.

Prayer For Relief

Wherefore, Plaintiff prays for the following relief:

(a) the Court determine that this action may be maintained as a class action under Rule 23(b)(3) of the Federal Rules of Civil Procedure and direct and reasonable notice of this action, as provided by Rule 23(c)(2) Federal Rules of Civil Procedure be given each and every member of the class represented by the Plaintiff in this action;

(b) the court determine that this action may be be maintained as a parens patriae action by the Attorney General of the State of Montana pursuant to Section 4C of the Clayton Act, 15 USC 4, on behalf of those natural persons residing within the jurisdiction of this court;

(c) the unlawful acts of the Defendants alleged herein be adjudged and decreed to be unlawful, unreasonable restraints of trade or commerce, and attempts to monopolize in violation of Sections 1, 2, and 3 of the Sherman Act 15 USC, Sections 1, 2, and 3;

(d) Plaintiff and those it seeks to represent in this action recover threefold the damages determined to have been sustained by each of them upon appropriate proof, and that judgment be entered in favor of Plaintiff against the Defendant herein for such sum;

(e) Plaintiff and those it seeks to represent recover the cost of suit herein, including reasonable attorney fees as provided by law;

(f) Plaintiff and those it seeks to represent herein be granted such other further and different relief as the nature of the case may require or as may seem to be just and proper in this court under the circumstances;

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(q) trial of this matter be by jury which the Plaintiff does hereby demand.

DATED this 1st day of May 1980.

MIKE GREELY, Attorney General
State of Montana

JEROME J. CATE, Chief
Antitrust Enforcement Bureau

George A. Losleben
GEORGE A. LOSLEBEN, Chief Staff Attorney
Antitrust Enforcement Bureau

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